WHAT'S WRONG WITH YOUR LIFE INSURANCE

NORMAN F. DACEY

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Norman F. Dacey

Angrily, authoritatively – and with brilliant clarity – one of America's leading estate planners chronicles the abuses of the insurance industry.

During the last 20 years, the life insurance companies of America have taken in $260 billion. They have paid out $89 billion. The mammoth difference is the price, he says, Americans have overpaid for protection.

Yet insurance men, says Mr. Dacey in this alarming volume, are greedy for still higher profit margins. They "have launched a concerted campaign to revive the myth that insurance is a savings and investment medium."

What's Wrong with Your Life Insurance spells out the promotional devices and disguises that are used to give a specious appeal to insurance contracts. The author pinpoints the "gimmicks" that pull extra dollars into insurance company coffers—beyond your basic premiums.

One of Mr. Dacey's bristling contentions: The huge cost of "cash value" insurance is robbing us of needed protection and will leave most of us bereft of security at 65.

The insurance industry actually pays out more in *commissions and expenses* than in *death claims*, says the author. Companies boast dazzling sales records but fail to mention that an amount of business equal to 80 per cent of the new policies sold goes off the books each year – with an annual billion-dollar loss to holders of lapsed or surrendered policies.

(continued on back flap)

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Preface

O! That deceit should dwell
In such a gorgeous palace. . . .
—*Romeo and Juliet*

Life insurance is one of the hallmarks of a modern civilized society. It is difficult to contemplate how we could get along without it.

Few things in this world are perfect, however, and the institution of life insurance has its imperfections. It is a curious phenomenon that only a bare handful of the people who create and sell life insurance admit an awareness of those imperfections. The vast majority of its practitioners insist that it be regarded as a sacred cow—above all question, criticism, or reproach.

Some of the books which draw attention to the imperfections of life insurance appear to have been written by people who hated life insurance companies.

I don't hate life insurance companies. I readily acknowledge that they do many things which are good. I contend, however, that they also do many things which are bad and which cry out for correction.

Early in this century, a governmental investigation of the life insurance industry uncovered monumental abuses, most of which subsequently were corrected. It will require another such investigation to dredge up the facts about a whole new set of abuses.

The life insurance industry is powerful. In many states it dictates the selection of the insurance commissioners supposed to regulate it; to all intents and purposes, it is unregulated.

Those who dare to point the finger of criticism at life insurance are not answered with reasoned argument but are as bitterly assailed as if they had attacked Motherhood or the Flag.

It is unlikely, then, that a congressional committee or other appropriate investigative body will soon beard this powerful lion in its den. Under present conditions, the best course for each individual American is to become familiar with the facts

about the use—and misuse—of life insurance, to the end that he may enjoy its benefits without becoming its victim.

In this spirit and without rancor, venom or bitterness, let us now consider what is wrong with your life insurance.

N. F. D.

49 Plaza
Bridgeport, Conn.

Everything humanly possible has been done to insure accuracy in the compilation of this book. Quotations are from authoritative texts or from trade journals considered reliable, and tables have been drawn from standard reference books. While expressing regret for any factual or typographical errors, the author confidently hopes that none will be found.

What's Wrong with Your Life Insurance

Chapter 1

The Mortality Table

THE MORTALITY TABLE—a historical, statistical record of the death rate in America—is the bedrock upon which all life insurance contracts are based. In theory, it tells the insurance actuary how many of 100,000 people, each insured for $1000, in each age group will die this year. He must then arrange for each of the 100,000 to pay a premium which, totaled for the group, will provide a sum sufficient to pay $1000 to the beneficiaries of each of those who have died.

Since the mortality table is a record of the past, it gives the insurance company a built-in advantage, for its experience under the policies the company issues this year actually will be determined by the death rate in the future.

Bear that in mind—the premiums you pay are based upon the *past,* while the death claims the insurance company pays are based upon the future.

Happily for us—and profitably for the insurance companies—human life expectancy in America has increased steadily year by year as science and medicine have progressed, as living standards have improved, and as the nutritional deficiencies of our people have been discovered and corrected. While this substantial improvement is quite evident in a comparison of our own life expectancy with that of earlier generations, the improvement in each single year is clearly discernible to the life insurance actuary. It follows, then, that the insurance company is bound to come out with some money left over if it bases its premium collections upon any previous year's mortality rate.

Under these circumstances, most people would assume that mortality tables are recomputed at reasonably frequent intervals so that the premiums will relate fairly to the actual mortality.

If that is what you think, disabuse yourself.

The majority of life insurance policies now in force in this country call for premium payments based upon the death rate before the American Civil War!

The premiums on these millions of policies are computed upon the basis of the American Experience Table of Mortality. First used in 1861, this table reflects the death rate in the United States during the period 1843–1858.

Consider for a moment the significance of this astonishing fact. Ponder the effect use of this obsolete mortality table has had upon the profits of the life insurance companies. By 1948, 192 million individual policies totaling over $206 billion worth of insurance were in force, all based upon the superannuated American Experience Table of Mortality.

The *1961 Statistical Bulletin* of the Metropolitan Life Insurance Company reported:

> With the close of 1960, the [company] completed a continuous record of the mortality among its industrial policyholders covering a 50-year period. Unprecedented reductions in mortality occurred during this half-century, reflecting epoch-making advances in medicine, public health and the general standard of living. The recorded death rate among these policyholders in 1960 was only about half that prevailing in 1911. Moreover, when adjustment is made for the increase in the average age of these insured lives, the current death rate is not quite a third of that in 1911.

The industrial insurance policyholders to whom the bulletin refers are mainly working-class people whom the company does not regard as preferred risks; the company's general mortality experience could be expected to show an even better result.

Actually, the outlook for the insurance companies is mighty bright. A past-president of the American Medical Association predicts that "in a couple of decades, average life expectancy will climb from the present 80 years to as much as 100 years." A recent report of the Senate Special Committee on Aging disclosed that while the number of people over 65 has doubled since 1920, the over-85 age group has increased 920%.

People are living longer. This means first that insurance companies are paying death claims years later than they had anticipated they would be required to pay them. The companies have had the use of the money all those extra years. It also means that people who live longer pay premiums longer, thus materially enhancing the companies' income.

Raymond T. Smith, vice-president of Alfred M. Best & Company, a recognized insurance authority, said in a talk to the Investment Analysts Society of Chicago:

> In recent years, excluding annuities, the companies have had the use of the policyholders' funds for longer periods than was contemplated by the mortality tables, which has had a beneficial effect upon earnings accruing to shareholders [of stock life insurance companies].

Finally, in 1948, a new mortality table became effective. Called the *1941 Commissioners Standard Ordinary* (or *CSO*) *Table,* it purportedly reflects the death rate in America during the ten-year period 1931–1941. Remember that there was no penicillin in 1941. Antibiotics, the "wonder drugs" so commonplace now, were either novel rarities or were unknown. Yet during all the years since 1948—with the nation's medical statisticians each year happily reporting some dread disease brought finally under control, with foundations that were formed to fight specific scourges turning to others because the original enemy has largely been conquered—through all of this, the life insurance industry continued to issue, without any apparent qualm, more than $600 billion worth of new insurance with premiums based upon the death rate during the ten years ending in pre-penicillin 1941.

X-17

Now and again, an honest—or merely nervous—actuarial voice has been raised, saying in effect: "Look, fellows, suppose they catch us at this? We'll be in real hot water. Let's take it a little easy, shall we? Let's give them a little break. We can afford it. Golly, we don't have to make it all this year!"

As long ago as 1956, a special committee of the American Society of Actuaries constructed a new mortality table mysteriously labeled *X-17.* The actuaries submitted this table to the industry with the statement that it would be "suitable as a permissive basis for the valuation of standard ordinary insurance." In other words, the companies could use the table if they wanted to.

Not a single American life insurance company adopted the table, not even those whose chief actuaries had served on the

committee that compiled and recommended it. They just couldn't bring themselves to get off the gravy train.

The *National Underwriter,* a leading trade journal in the industry, editorialized uneasily in its October 25, 1957, issue:

> If the industry position with regard to X-17 isn't handled with due regard for the public relations angles, it could give destructive critics of the business a field day the like of which they've never enjoyed. Distortions and half-truths could poison the public's mind so that it would take years of effort to get rid of these misconceptions.

As I read it, this means: If we come out with this new mortality table and the suckers find out how badly they've been taken with these obsolete mortality tables we've been using all these years, there'll be the devil to pay. We'd better be very careful how we explain it to them.

Continues the *National Underwriter* editorial:

> The present CSO [*Commissioners Standard Ordinary Table of 1941*] is far from reflecting improved, present-day mortality. . . . The CSO table formerly was the nearest thing to a current mortality table.

You'll notice that this authoritative journal doesn't pretend that the CSO table *ever* accurately reflected the true mortality figures. It was just "the nearest thing" to a correct table.

The editorial goes on:

> So, of course, in their day, were the mortality records of the time of the Black Plague. But neither Black Plague mortality nor that on which the CSO table was based is a realistic table for today's use. About all that can be said for the CSO table is that it is somewhat less inappropriate than Black Plague mortality rates would be.

Can you imagine the outcry today if fire insurance companies based their rates upon the flimsy wooden buildings and primitive fire-fighting equipment in use at the time of the Chicago Fire?

The editorial concludes:

> The X-17 table, even if it should supersede the CSO table, would have an important public relations flaw: It is not a table that reflects the actual mortality as found but has a margin for safety so as not to be too rough on companies that haven't quite as good mortality as the average of those represented in the X-17 data.

So the actuaries, having got together to make an honest woman out of the life insurance industry, couldn't quite bring themselves to go all the way. In order not to be "too rough" on companies with careless underwriting practices, they compiled a deliberately distorted mortality table and recommended it to the industry as a "suitable" basis for the computation of premiums.

Having created a mortality table calculated to quiet the worried few who warned, as did the *National Underwriter*, that eventual exposure was inevitable and likely to create public indignation, the actuaries on the committee went home and apparently forgot the whole thing. They had supplied a means of putting life insurance on a more honest basis. Now it was up to the companies.

Not a single company adopted it.

Deliberately loaded as it was in the companies' favor, the new X-17 still cut too deep into their profits.

The 1950s ended with new life insurance selling at an all-time record to the best-fed, best-housed, healthiest generation of Americans since the Republic was founded—at the same pre-penicillin 1941 rates.

Investment in the stock of life insurance companies became more and more widespread as brokers all over the country drew attention to the fabulous profits of the stock life insurance companies. One Hartford company planned a new home office, to cost $4 million. Between policies sold before 1948 based upon pre-Civil War death rates and the policies sold after 1948 based upon the pre-penicillin death rate of 1941, profits were so lush that by the time the company moved into the new building, it had expanded the facility to a $23-million Taj Mahal complete with swans in a reflecting pool.

By and large, the only people who know about life insurance are the insurance men themselves—and you surely don't expect them to draw public attention to this mortality-table bonanza.

Mortality Ratio

But there is one place their slip is showing. In the annual reports they prepare to impress the faceless, numbered policyholders with their stewardship, they cannot resist giving themselves a little pat on the back for their "mortality ratio." Mortality ratio simply indicates the ratio of actual to expected mortality. For example, if a company's mortality ratio is reported as 50%, this means that for each 100 death claims projected in their estimates, they actually had to pay only 50. They explain proudly that this reflects their careful underwriting. What it really means, of course, is that the company collected enough premiums to pay 100 death claims and actually paid only 50. The difference represents a profit. Mutual life insurance companies claim that the mortality saving goes right back to the policyholders in the form of a dividend, a claim we shall explore later. Stock companies simply absorb the mortality savings as profit.

The huge mortality "saving" may be due in some small measure to careful underwriting, but the bulk of it comes from use of that Civil War mortality table and the CSO 1941 table which the *National Underwriter* termed only "somewhat less inappropriate than Black Plague mortality rates."

Listed below are the 1960 mortality ratios of some of the leading companies.[1]

TABLE 1

Ratio of Actual to Expected Mortality—1960
United States Life Insurance Companies

Company (in order of size)	*Ratio (%)*
Metropolitan Life	51.2
Prudential	44.7
Equitable Life of New York	60.7
Travelers	50.3
John Hancock Mutual	50.8
Aetna Life	50.0
New York Life	43.4
Connecticut General	46.3
Lincoln National Life	47.7
Northwestern Mutual	39.6
Occidental Life of California	53.7
Massachusetts Mutual	47.3
Mutual of New York	45.1

[1] Prepared for the author by A. M. Best and Co.

TABLE 1 (continued)

Company (in order of size)	*Ratio (%)*
New England Life	45.3
Continental Assurance	51.0
National Life & Accident	37.4
Mutual Benefit Life	44.7
American National	43.8
Penn Mutual Life	42.3
Western & Southern	41.1
Connecticut Mutual Life	38.9
Franklin Life	32.3
Bankers Life of Iowa	43.6
General American Life	62.2
California-Western States	52.9
State Mutual Life	54.4
Union Central Life	55.2
Republic National Life	59.3
Provident Life & Accident	70.8
Pacific Mutual	53.6
Old Republic Life	67.1
National Life of Vermont	35.6
Life of Virginia	52.3
Minnesota Mutual	51.5
Provident Mutual	41.8
Phoenix Mutual	34.6
Northwestern National	46.8
Home Life of New York	40.3
United Benefit Life	53.2
Southwestern Life, Texas	47.9
Jefferson Standard	42.9
Liberty National	47.3
Business Men's Assurance	45.3
Guardian Life of New York	43.0
Life & Casualty, Tenn.	33.8
Washington National	52.3
Acacia Mutual	39.2
Nationwide Life	38.1
Life of Georgia	46.0
Equitable Life of Iowa	37.2
Pilot Life	57.8
State Farm Life, Ill.	28.3
Allstate Life, Ill.	49.1
United States Life, N.Y.	53.3
American United Life, Ind.	49.3
Manhattan Life	54.7
North American Reassurance, N.Y.	37.9
Kansas City Life	42.9

TABLE 1 (continued)

Company (in order of size)	*Ratio (%)*
Southland Life	55.7
Commonwealth Life	49.9
Gulf Life, Fla.	59.9
Pan-American Life	46.6
Credit Life	60.4
Fidelity Mutual Life	36.7
Liberty Life, S.C.	47.2
Security Life & Trust, N.C.	39.3
Capitol Life, Colo.	70.1
Monumental Life	39.3
Protective Life, Ala.	58.3
Union Labor Life, N.Y.	78.7
Cavalier Life, Md.	63.7
Ohio National Life	42.2
Great Southern Life, Texas	51.4
Union Mutual Life, Me.	73.4
North American Life & Cas., Minn.	48.1
Independent Life & Accident, Fla.	90.9
Home Beneficial Life, Va.	45.1
Country Life	30.0
Paul Revere Life	52.3
Average	48.9

Note that of the 79 companies listed, 30 had a mortality ratio between 40 and 50 per cent, which means that they collected at least *twice* the premiums they needed to fulfill their obligations.

Fourteen other companies had mortality ratios between 30 and 40 per cent. The blue ribbon went to the State Farm Life of Illinois, with a fantastic 28.3 per cent mortality ratio. That company hauled in more than three times as much premium income as it needed!

New Mortality Table

In 1961, a new mortality table (called the *Commissioners Standard Ordinary Table of 1958*) was proposed. Although said to be based upon the true death rate in the years 1950–1954, it presented mortality figures well above those set by the earlier X-17, which we have already seen was loaded in favor of the insurance companies. Thus far, only a few companies have adopted the new table. It will become mandatory in

1966, however. By then, its figures will be twelve years old and presumably may be depended upon not to cut too deeply into the industry's profits.

With the new table effective in 1966, will we be able to buy life insurance any cheaper? Will some of the benefits be increased? Well, David G. Scott, first vice-president of Continental Assurance, told the New York Supervisors Association:

> Under the new table, cash values will go down unless the companies increase their interest assumptions. Extended term insurance calculations will be the same, paid-up values about the same, and *net cost on participating forms little changed.* [Italics added.]

It doesn't seem that the new table holds much prospect of improved insurance benefits for the policyholders.

A cure for cancer would advance the average life expectancy of the American male from the present 68.07 to 89 years. Contemplation of the resulting profits to his company is enough to gladden the heart of even the most jaded insurance-company president.

In governmental circles today, it is fashionable to devote a considerable amount of time and money to searching out those who conspire against the public good—those who conspire to set prices for the things they manufacture, for example. Some rather distinguished businessmen have languished in jail and the giant corporations by whom they were employed have paid heavy fines, all because they got together to work out an agreement by which the public paid a rigged price for the product.

What shall we say of the life insurance industry which for more than a hundred years has charged the American people premiums based upon antiquated mortality tables? How shall we regard an industry which sanctimoniously parades its almost holy zeal to fulfill its mission of bringing financial security to the widows and orphans of hard-working Americans—and then gouges them with premium rates based upon admittedly rigged mortality tables?

It took the life insurance industry nearly half a century to live down the revelations of the Armstrong investigation of 1905 (see Chap. 2). When the facts of its gross misuse of the mortality tables become public knowledge, how long will it take the industry to live *them* down? Will not the worst fears of the *National Underwriter* be realized?

Selection

The life insurance industry's advantage from mortality tables does not end there. Mortality tables, whenever and however honestly or dishonestly they may be compiled, represent a cross section of the *entire* population of the country—from tiny babes to octogenarians, people in vibrant good health and others in the last days of terminal illness. Every individual in the country is taken into account in arriving at the figures in the table.

But life insurance companies will not insure all of these people. Policies issued on newborn infants contain a clause sharply reducing the company's liability during the early years of life so that the premiums are outrageously high. Insurance companies ordinarily do not issue new policies to people over age 65, thus avoiding the age group most likely to create claims. Everyone, young or old, must prove good health to the satisfaction of the company, generally by undergoing a physical examination. Persons in certain hazardous occupations are denied insurance altogether or required to pay an extra "rating." Those in occupations regarded by the insurance company as unsavory are rejected.

By a process of selection, then, the insurance company creates a likelihood that its experience will be far, far better than that forecast by the mortality table.

Policy Switching

Insurance men insist that it is very costly to give up an old policy and replace it with a new one. However, if the abandoned policy called for premiums based upon the old, obsolete mortality tables and the new policy's premiums are based on the new table (however questionable the new table may be), substantial savings may be effected. True, acquisition costs have to be paid again but if the new policy is selected carefully to provide protection alone, with no savings or investment element whatever, these costs can be kept to a minimum and the change may be quite worthwhile.

Mutual life insurance companies, companies with no stockholders which claim to be owned by their policyholders, aver that the mortality overcharge we have been discussing here is more significant with stock companies than with mutuals. Whereas the stock companies sell their policies at a flat fixed charge euphemistically called a "guaranteed" rate, the mutuals

claim to make up for the mortality overcharge by returning to the policyholder something they quite solemnly refer to as a "dividend." If this claim were true, then when mortality experience is only half as bad as expected, would not "dividends" be twice the anticipated figure? Alas, they are not so—as we shall see presently.

Extended Term Option

All companies, both stock and mutual, include an "extended term insurance" option among their nonforfeiture values. This is a form of single-premium term insurance policy. The cash value of the old policy is used to continue the policy's face amount of protection for as many years and days as the cash value will buy. But the date to which coverage is to be extended without the payment of any more premiums is inflexibly fixed, and no future dividends of any kind are paid. If the mutual insurance company's claim that it makes up for the mortality overcharge through the payment of dividends is valid, how does it make it up on extended term insurance?

The need for more adequate regulation of insurance company rate-making is pointed up by the manner in which this extended term insurance option is computed. Insurance companies are now permitted by statute to adjust their rates upward capriciously whenever it suits their purpose to do so. Thus, they pay lip service to the established mortality tables while reserving the right to sweeten the kitty whenever they choose. They try to apply their actuarial jiggery-pokery in places where it will not show up in a comparison of their rates with those of their competitors. The extended term option is a favorite place to clip a little precious metal off the edge of the coin unobtrusively. For example, Milton J. Goldberg, research director of the Equitable Life Assurance Society, noted in an article called "Non-Forfeiture Values and Policy Loans":

> Companies are permitted by statute to assume a relatively high mortality rate in calculating the period of coverage [purchased by the cash value] under this [extended term insurance] option. The use of such assumption shortens the period involved.

What Goldberg means is that when two men are covered by insurance, one under a standard form of ordinary life

policy on which premiums are being paid currently and the other under an extended term insurance option, the company is entitled to apply a "relatively high mortality rate" to the man covered under the extended term option. The theory does not explain why a man is deemed more likely to die than another man simply because the policy in his strongbox has something different written on it than does the policy held by the other man.

Through all of these machinations with the mortality tables, insurance companies profit beyond reason.

This is the first thing that is wrong with your life insurance.

Dig out your policies tonight and examine the sections deep inside headed "Non-Forfeiture" or "Basis of Reserves." There it will tell you whether your premiums are computed upon the basis of the death rate before the Civil War (the American Experience Table of Mortality), the pre-penicillin decade of 1931–41 (the *Commissioners Standard Ordinary Table 1941*), or the 1950–54 years (the new *Commissioners Standard 1958 Table*).

Here is a comparison of the death rates under these three tables and the rejected X-17 table with actual mortality experience of American life insurance companies during the decade 1950–1960:[2]

TABLE 2

Deaths Per Thousand

Age	*American Experience Table*	*Commissioners 1941 Table*	*X-17*	*Commissioners 1958 Table*	*Actual Insurance Co. Experience 1950–1960*
20	7.80	2.43	1.46	1.79	.85
21	7.86	2.51	1.49	1.83	.87
22	7.91	2.59	1.52	1.86	.89
23	7.96	2.68	1.54	1.89	.90
24	8.01	2.77	1.57	1.91	.92
25	8.06	2.88	1.59	1.93	.93
26	8.13	2.99	1.62	1.96	.95
27	8.20	3.11	1.66	1.99	.98

[2] Compiled from *Life Insurance Fact Book (1961)* and special data supplied by the Institute of Life Insurance.

TABLE 2 (continued)

Age	*American Experience Table*	*Commissioners 1941 Table*	*X-17*	*Commissioners 1958 Table*	*Actual Insurance Co. Experience 1950–1960*
28	8.26	3.25	1.70	2.03	1.00
29	8.34	3.40	1.76	2.08	1.04
30	8.43	3.56	1.82	2.13	1.08
31	8.51	3.73	1.89	2.19	1.13
32	8.61	3.92	1.96	2.25	1.18
33	8.72	4.12	2.04	2.32	1.24
34	8.83	4.35	2.14	2.40	1.32
35	8.95	4.59	2.25	2.51	1.41
36	9.09	4.86	2.39	2.64	1.53
37	9.23	5.15	2.56	2.80	1.68
38	9.41	5.46	2.77	3.01	1.87
39	9.59	5.81	3.02	3.25	2.10
40	9.79	6.18	3.30	3.53	2.36
41	10.01	6.59	3.60	3.84	2.64
42	10.25	7.03	3.93	4.17	2.95
43	10.52	7.51	4.28	4.53	3.28
44	10.83	8.04	4.65	4.92	3.63
45	11.16	8.61	5.06	5.35	4.02
46	11.56	9.23	5.51	5.83	4.45
47	12.00	9.91	6.00	6.36	4.92
48	12.51	10.64	6.55	6.95	5.46
49	13.11	11.45	7.16	7.60	6.06
50	13.78	12.32	7.84	8.32	6.72
51	14.54	13.27	8.60	9.11	7.45
52	15.39	14.30	9.44	9.96	8.21
53	16.33	15.43	10.37	10.89	9.02
54	17.40	16.65	11.41	11.90	9.92
55	18.57	17.98	12.55	13.00	10.91
56	19.89	19.43	13.81	14.21	12.01
57	21.34	21.00	15.20	15.54	13.22
58	22.94	22.71	16.73	17.00	14.55
59	24.72	24.57	18.39	18.59	15.99
60	26.69	26.59	20.20	20.34	17.57

Chapter 2

History

THE FIRST recorded life insurance policy was issued in London on June 18, 1536, on the life of William Gybbons.

It was a one-year policy—and Gybbons died within the year, on May 29, 1537. History does not reveal the cause of death; perhaps he was cut down in the prime of life by a hit-and-run bullock cart on The Great West Road.

More interesting for our purposes here is the fact that the underwriters refused to pay on the grounds that a year consisted of twelve months of four weeks each. They insisted that Gybbons had lived the full year by their reckoning and they were off the risk. Fortunately for Mrs. Gybbons and the children, the court ruled against the underwriters and they were forced to pay.

Late in the next century, in 1699, the Society of Assurance for Widows and Orphans was founded in London. In form it was rather like the present fraternal insurance companies.

Chronicles of the early days of life insurance in our own country provide interesting reading. For example, in the 1870s, many policies did not pay for "fatal or non-fatal injuries caused by Indians" or death caused by "dueling, fighting, lifting or over-exertion." At one time, the Travelers Insurance Company required a special permit and an extra premium for any traveler who voyaged "past or around Cape Hatteras or upon the high seas."

The concept of group insurance came into being when a cargo of Chinese laborers was to be transported aboard the clipper ship *Sea Witch* from Swatow, China, to Panama. The 700 coolies were valued at $120 each, and the shipowners took out $84,000 of "group" insurance with an American insurance company.

Life insurance has come a long way since that day long ago when William Gybbons laboriously put his signature to a piece of paper atop a plank of English oak. Today it is the largest financial institution in the world.

The Armstrong Investigation

The institution has suffered growing pains. Between the Civil War and the turn of the twentieth century, life insurance made a place for itself in America—but it did not escape the notice of the "robber barons" and many a premium dollar found its way into dishonest hands. The mounting transgressions, even of those who constituted the more respectable element in the industry, finally so outraged the public that the historic Armstrong Joint Legislative Inquiry of 1905 took place. Under the relentless probing of the committee, the life insurance industry was turned inside out and a fantastic host of evil practices revealed. I shall not recite them here. They are history—ancient history—and we are not particularly concerned with what happened half a century or more ago. Our interest is in what is happening today.

When the Armstrong investigation was over, the life insurance industry stood naked and ashamed before a shocked public. Its reputation for honesty and fair dealing was in shreds. It began the tedious job of regaining public confidence. It was slow, hard going. The ghosts of the Armstrong investigation haunted the industry's home offices for two generations.

The men who sorted out the wreckage and began rebuilding are dead now. Today, a whole new generation of insurance executives are at the helm. Many of them have been infected by the disease of commercialism which seems to characterize our times. It is possible that they don't know about the Armstrong investigation. If they do know about it, they have obviously forgotten the lesson it taught the industry.

Stock and Mutual

At latest count, before publication, there are 1465 legal reserve life insurance companies in the United States and Canada, with $635 billion worth of life insurance in force. Company assets total a staggering $126.3 billion. In 1961, $79.5 billion worth of new insurance was purchased. Death benefits paid were $3.6 billion, and so-called living benefits totaled $5.1 billion.

Of the 1465 companies, 1312 are "stock companies" and 153 are "mutual companies," but the mutual companies account for more than 61% of all the insurance in force. Stock companies are corporations like any others, organized for profit. Mutual companies have no stockholders. They are

supposedly owned by their policyholders. Supposedly, they are nonprofit organizations—you might call them insurance cooperatives—making protection available at cost to policyholders.

It is the practice of mutual companies to overcharge on their premiums on the grounds that a plague or other disaster may overtake them and make their actual mortality experience less favorable than could be anticipated when premium rates were established. In theory at least, if they escape the plague they refund the overcharge as a "dividend" to policyholders. Here the word *dividend* is a misnomer. The dictionary says that a dividend is literally a share of anything that is divided, but by common usage it has come to connote a distribution of income or profits. Most people are under the impression that the dividend they receive on their mutual life insurance is some sort of profit on their money. The tip-off, of course, is that they pay no income tax on it. It isn't taxed because it isn't income. (The matter of insurance dividends will be explored in more detail later.)

True dividends are paid by the stock companies not to the policyholders but to the stockholders. The stock companies skip the mutual companies' pretense of being quasi-charitable institutions and admit frankly that they're in business to make money. Stock companies don't seem to worry about the unpredictable disaster which impels the mutual companies to overcharge on premiums. They figure that the hoary old mortality tables they use are all they need to insure profitable operation.

To meet the competition of the mutual companies, the stock companies generally offer a line of "participating" policies. They simply charge you more and give you back a little of it. In the trade, the offerings of such companies are identified as "par" (short for "participating") and "non-par" policies. Of all the life insurance in force with United States legal reserve companies, 67% is participating and 33% is on a nonparticipating basis. About 61% is in mutual companies "owned" by the policyholders and 39% is in companies owned by the stockholders.

Although most of the insurance in force is in mutual companies, the mutuals' share of all life insurance is growing smaller simply because no new mutual companies are being organized, while stock companies are springing up everywhere. In 1946 the stock companies had 30.7% of the business,

32.7% in 1950, 36.8% in 1955, and 38.6% in 1960. During the past ten years, insurance in force with mutual companies has increased 133% whereas that in stock companies has grown 202%.

A great many of the 1465 life insurance companies in existence today are relatively small stock companies. The legal requirements are such that it is almost impossible to organize a mutual company, and none has been organized in years. It is no job at all to organize a stock company, however, and 700 new stock companies have come into being during the last ten years. A recent survey disclosed that 15.9% of all legal reserve life insurance companies were then less than two and a half years old. Less than 1% of U. S. life companies operate in all 50 states.

Financial Power

The life insurance industry holds in trust for the people of the United States and Canada $126.3 billion of assets. This is unquestionably the greatest concentration of private financial power in the world. Four giant mutual companies control 44% of these assets. Ten companies control 63% of the assets; 49 control 84%.

Let's stop here and take a look at the giants. Listed below in the order of their amounts of insurance in force are the 79 largest American life insurance companies:[1]

TABLE 3

United States Life Insurance Companies
Rank Insurance in Force—1960

No.	*Company*	*Amount*
01	Metropolitan Life	$94,245,883,078
02	Prudential	82,182,997,497
03	Equitable Life of New York	38,437,328,870
04	Travelers	26,961,412,902
05	John Hancock Mutual	26,184,481,342
06	Aetna Life	24,311,020,459
07	New York Life	24,043,900,323
08	Connecticut General	11,373,009,496
09	Lincoln National Life	10,570,172,115
10	Northwestern Mutual	10,410,515,107

[1] Prepared for the author by A. M. Best and Co.

TABLE 3 (continued)

No.	*Company*	*Amount*
11	Occidental Life of California	$10,206,576,348
12	Massachusetts Mutual	8,278,463,591
13	Mutual of New York	8,140,623,358
14	New England Life	7,042,890,567
15	Continental Assurance	6,844,389,993
16	National Life & Accident	5,855,138,232
17	Mutual Benefit Life	5,594,819,863
18	American National	5,591,603,857
19	Penn Mutual Life	5,249,482,643
20	Western & Southern	5,241,276,317
21	Connecticut Mutual Life	4,700,113,732
22	Franklin Life	4,047,274,323
23	Bankers Life of Iowa	3,760,170,334
24	General American Life	3,249,186,688
25	California-Western States	3,187,569,114
26	State Mutual Life	3,125,055,786
27	Union Central Life	3,043,984,830
28	Republic National Life	2,974,869,128
29	Provident Life & Accident	2,864,221,539
30	Pacific Mutual	2,785,538,906
31	Old Republic Life	2,760,677,927
32	National Life of Vermont	2,750,524,331
33	Life of Virginia	2,744,458,658
34	Minnesota Mutual	2,689,960,130
35	Provident Mutual	2,624,752,792
36	Phoenix Mutual	2,448,652,947
37	Northwestern National	2,382,860,446
38	Home Life of New York	2,240,884,146
39	United Benefit Life	2,160,924,702
40	Southwestern Life, Texas	2,116,626,295
41	Jefferson Standard	2,010,954,712
42	Liberty National	2,002,047,188
43	Business Men's Assurance	2,001,706,988
44	Guardian Life of New York	1,952,309,624
45	Life & Casualty, Tenn.	1,920,885,605
46	Washington National	1,908,306,523
47	Acacia Mutual	1,876,342,937
48	Nationwide Life	1,808,782,669
49	Life of Georgia	1,784,267,764
50	Equitable Life of Iowa	1,773,299,887

TABLE 3 (continued)

No.	*Company*	*Amount*
51	Pilot Life	$1,753,563,655
52	State Farm Life, Ill.	1,734,840,597
53	Allstate Life, Ill.	1,660,884,961
54	United States Life, N.Y.	1,650,840,315
55	American United Life, Ind.	1,578,592,094
56	Manhattan Life	1,523,846,168
57	North American Reassurance, N.Y.	1,437,870,248
58	Kansas City Life	1,428,012,566
59	Southland Life	1,426,219,404
60	Commonwealth Life	1,402,544,270
61	Gulf Life, Fla.	1,365,751,004
62	Pan-American Life	1,322,379,236
63	Credit Life	1,319,335,821
64	Fidelity Mutual Life	1,316,873,067
65	Liberty Life, S.C.	1,292,341,419
66	Security Life & Trust, N.C.	1,244,074,608
67	Capitol Life, Colo.	1,241,783,786
68	Monumental Life	1,150,223,262
69	Protective Life, Ala.	1,143,644,709
70	Union Labor Life, N.Y.	1,096,405,179
71	Cavalier Life, Md.	1,084,581,654
72	Ohio National Life	1,082,776,205
73	Great Southern Life, Texas	1,076,086,410
74	Union Mutual Life, Me.	1,064,290,947
75	North American Life & Cas., Minn.	1,033,401,127
76	Independent Life & Accident, Fla.	955,861,205
77	Home Beneficial Life, Va.	953,450,361
78	Country Life	934,409,145
79	Paul Revere Life	896,028,512

(One company, Cuna Mutual, whose $5.765 billion worth of insurance in force would have ranked it in seventeenth place, has been omitted because it sells only to credit union members and not to the public at large.)

These companies occupy some of the most magnificent real estate in America. By and large, life insurance premiums are hard come by so far as the policyholder is concerned. It is safe to say that a very large proportion of policyholders have sacrificed on many a premium due-date in good years and bad, through booms and depressions, to scrape together the

money to keep their insurance in force. The companies have lavished more than a billion dollars of those hard-earned premiums on new home offices and branch offices—and the tide of new buildings rises with each passing month.

A typical example is the new home office building of Equitable Life in New York. In full-page advertisements in leading newspapers and magazines, the company gloated:

> This is the new home that Living Insurance built. Soaring 42 stories to the sky, Equitable's majestic new home office stands as a symbol of security for millions of people. Today, as for more than a century, Equitable is ready to serve the insurance needs of America.

The *National Underwriter* described the building as "lushly furnished, with luminous ceilings, walls of English oak and teakwood, abstract impressionist paintings, modern furniture and bamboo screens." There is an elaborate health center for employees. Presumably, the policyholders get their exercise trying to dig up the premiums to pay for this palace. (It's those abstract impressionist paintings that run up the cost of insurance these days!)

Not so long ago I visited the home office of one of the larger mutual companies in New York City. At lunchtime I was led to a handsome cafeteria where I queued up with the employees. The food was wonderful; the appointments were as fine as those in a smart restaurant. Subdued lighting and soft music added charm to the meal. All in all, it was a delightful dining experience. There was just one thing which puzzled me.

There was no cashier—everything was on the house.

Chapter 3

Company Practices

MUTUAL insurance companies spend money freely. A favorite item of heavy expense is conventions. Consider National Life of Vermont, which held its last convention in Hawaii, nearly 6000 miles from its home office in Montpelier. Conventions are common throughout business and industry, but they are customarily paid for by the stockholders of the companies, who have the privilege of deciding whether the officers are spending too much money. If the stockholders don't like the way the officers run the company and spend the money, they can remove the officers. We shall explore presently the possibility that mutual insurance company policyholders have any influence whatever upon the officers and directors who run the company. We will find that these mutual insurance company officers are responsible to no one—literally no one—for the money they spend.

I was once the guest of a large mutual insurance company at a dinner for 1200 of its agents given at the Waldorf-Astoria Hotel in New York. Most of the men were industrial insurance agents who collected premiums weekly. From their speech and their manners one could surmise that a good many of them would have been more at home eating on a stool in Joe's Diner in Hoboken. I queried one of the company executives about the fees of the stage stars who were entertaining the group. He confided that the party was costing the company $100,000. Correction: the party was costing the *policyholders* of this mutual company $100,000. The revelry at the Waldorf went on far into the early morning, liquor flowing freely.

In 1960, this company terminated a quarter of a million individual life insurance policies on which it paid not a penny of surrender benefits of any kind.

Expenses

Here are some sample items in insurance company budgets: One hundred and thirty-six insurance companies support a

Life Insurance Research Fund to which they have contributed more than $14 million of the policyholders' money without any authorization whatever. Thirty-five companies participate in the New England Colleges Fund, to which they make substantial contributions.

The Connecticut Mutual Life Insurance Company makes an annual contribution to the alma mater of every home-office employee who is a college graduate. Any employee of the company may make a gift to any college, and the company will match it up to $300.

The Aetna Life goes Connecticut Mutual one better—gifts of up to $500 by employees or agents to any college or university are matched by the company. Gifts made by agents' or employees' wives in their own name are also matched. These company "expenses" reduce the amounts available for payment as dividends on participating policies and thereby increase the cost to the policyholder for the protection. The policyholders have no voice in determining whether or not such expenses shall be incurred—a policyholder in Rochester pays more for his insurance protection simply because the wife of an Aetna agent in San Francisco decides to give her alma mater a gift of $500.

The Institute of Life Insurance is the chief propaganda agency of the industry. Elsewhere in this book will be found excerpts from an article detailing its myriad activities. Some of these activities wear the sinister aspect of thought control. Supported by the member companies with policyholder funds, the Institute has created a network of propagandists to tell and sell the "permanent" life insurance story to people of all ages in every walk of life. For example, in the summer of 1962, the Institute paid the expenses of 580 teachers from all parts of the country who attended "workshops in family finance" sponsored by the insurance departments of a number of colleges enjoying the financial patronage of the life insurance industry. Many of these teachers returned home to become propaganda "cells" for the industry, promoting life insurance to the children in their classes and to the womens' clubs and other groups before whom they lecture on "family finances."

Prudential awards $10,000 in scholarships annually to college students interested in becoming actuaries. New England Life guarantees scholarships of up to $6000 to children of company employees, home office or field, who qualify under a

scholarship plan. In 1962, Equitable made grants totaling $175,000 to privately supported liberal arts colleges.

It may be quite proper for private corporations, with the approval of their stockholders, to make contributions to American educational institutions. But these mutual life insurance companies belong to their policyholders. They are supposed to be "cooperatives," nonprofit institutions operated to provide life insurance protection at the lowest possible cost to policyholders. The officers of these companies hold the funds in a fiduciary capacity, as trustees. The policyholders whose money they are thus lavishly dispensing have given them no authorization whatever to do so. The officers don't even tell the policyholders about it, as a rule, much less ask their permission.

Connecticut Mutual sent out a publicity release to the trade journals announcing that the company had "launched a broad program of aid to higher education consisting of matching gifts and outright grants, all unrestricted." Don't look now, but if you are a Connecticut Mutual policyholder, that was *your* money they were giving away!

The same company has distributed free *25 million* full-color reproductions of paintings and water colors by 150 contemporary American artists. President Charles J. Zimmerman and his colleagues are probably genuine art lovers and it may well be that this fine gesture has set art ahead 25 years. No doubt it has set the fortunes of several firms with color presses ahead almost as far.

I contend that the men who run Connecticut Mutual are there not to patronize the arts but to provide life insurance protection to the policyholder-owners of the company at the lowest possible cost. Most of those policyholders are underinsured. They have bought all the insurance that they can afford at the price charged for it by Connecticut Mutual. It was *their* money, their hard-earned premium dollars, which paid for those 25 million pictures. In my view, it was a monstrous imposition upon them.

In 1961, Massachusetts Mutual gave $75,000 to the Springfield United Fund. Again I say that it may be all right for a private corporation to give away the stockholders' money. But I believe that no mutual insurance company has the right to give a chunk of the policyholders' money to anyone, charity or not. Each policyholder of the company is probably contributing to the local United Fund in his own community.

There is no reason why his life insurance policy should be charged with the support of a United Fund in a city a thousand miles distant from his own.

If I have some money in a savings bank in Podunk, Pennsylvania, I don't expect the bank's officers to deduct a little of it to make a contribution to the local United Fund. It's my money, and I have a right to choose my own charity. They have no right to contribute my money to charity, no matter how worthy. I feel the same way about money I have on deposit with an insurance company.

The State Mutual Life Insurance Company of Worcester, Massachusetts, is a mutual company. It is a nonprofit enterprise with no stockholders, owned by the policyholders. Yet its officers have established a "profit sharing plan" for employees calling for annual company contributions of up to 9 per cent of annual base salary. The new plan is in addition to the existing group life insurance and pension plans.

I happen to have a policy in State Mutual, a group coverage which I believe is a good one. I also happen to know that they pay their claims very promptly. All in all, I have the impression that they're pretty nice people up there in Worcester.

But who do they think they are, setting up a plan to "share" the profits. Whose profits? What a bold imposition upon the policyholders! Has the insurance industry lost all restraint?

A friend of mine, an executive of Metropolitan, returning to work after a heart attack, reported to me that the company had welcomed him back with another $30,000 worth of coverage under the free group insurance they were providing for their own employees.

Subsidies to Teachers

Another phase of this giveaway needs to be examined. This one involves the subsidizing of colleges and of individual educators, generally in state universities and other small non-Ivy League institutions. For example, the New York Life made a grant of $15,000 of the policyholders' money to Georgia State College "in recognition of the contribution of the college to the insurance industry in providing a regional program of education in life insurance."

Professors of economics and insurance in many educational institutions across the country are being subsidized by the life insurance industry. The professors write articles, make

speeches, or conduct special training courses for insurance men on the campus. In such cases and in the case of New York Life cited above, we see examples of money which rightfully belongs to the policyholders of mutual insurance companies being given away in the form of a subsidy or "grant" for a contribution by the individual or institution to the sales objectives of the life insurance industry.

Suppose Siwash College runs a school for automobile salesmen and as a gesture of appreciation, General Motors announced that it was adding $5 to the price of every car it sold and turning the money over to Siwash. A great many people might write to General Motors and suggest that if it wanted to make a contribution to Siwash for its help to the auto people, it should find some other way to do it than by a direct levy upon car buyers.

Under the guise of "fellowships," scores of American college and university teachers spend their summer months in "study" at insurance-company home offices, being indoctrinated with the industry's philosophy and practices.

In between the "seminars" which they conduct for the training of insurance salesmen, many of these subsidized professors of insurance write articles for strategically useful medical journals, teachers' magazines, and similar publications. The articles generally extoll the virtues of high-cost cash value insurance, which the insurance companies delight to sell. These inspired pieces are accepted by unsuspecting readers as the opinions of impartial experts. On the strength of them, many such readers embark upon insurance plans which are unsound, a fact which they may discover in a year or three or five. Off the companies' books the policies will go —and the skyrocketing lapse ratio will be given another nudge upward.

Be wary of the effusions of these professors "kept" by the insurance industry. Remember: to be worthwhile, advice must be both expert *and* unbiased.

The money these insurance companies are dealing out with a lavish hand in the educational field is the policyholders' money. It represents premiums usually hard-earned and occasionally delivered to the insurance company at great personal financial sacrifice. Why does no one hold the companies to account? Why should the insurance companies use part of the policyholders' money to thus exploit colleges and educators?

In business and industry, executive retirements are usually announced by the executive himself or by his company. In the case of Thomas I. Parkinson, autocratic chairman of the board of the giant Equitable, third largest American insurance company, his "retirement" was announced by the New York Superintendent of Insurance. Parkinson was not a well man, the superintendent reported, and was resigning for reasons of health, to which Parkinson replied, "I am not ill and I will not resign."

It all began when the New York State insurance examiners observed that Equitable had loaned $32,661,746.59 of the policyholders' money to Glenn McCarthy, a Texas oil wildcatter. The loan had gone into default within the first year, the company receiving neither principal nor interest. Things went on that way, with Equitable apparently not pressing the matter. Delving deeper, the examiners found three Equitable executives on the McCarthy payroll. One was being paid $30,000 a year; the others each drew $10,000, in addition to their Equitable salaries.

The examiners' report said: "The circumstances under which these salaries were paid were reviewed by the examiners and were discussed with the society." The upshot: the trio handed over to Equitable all that they had received from McCarthy and "Equitable transmitted its check to the McCarthy Oil & Gas Corporation for the amount refunded."

In another area of the company's activity, the report disclosed that Equitable had announced that it was expanding its newspaper advertising and was appointing C. V. Parkinson Associates to conduct the program. C. V. Parkinson was Chairman Parkinson's young son Courtney. Said the report: "There is no evidence that this firm functioned as an advertising agency on a nationwide scale before it was favored with the Equitable account." The agency had been incorporated a couple of years earlier with an authorized capital of $1000. Shortly after the announcement of the Equitable account, this was raised to $2000. This capitalization, however, proved sufficient for a considerable volume of business. In 1949–50, Equitable placed $950,920 worth of advertising through the agency. At the standard agency commission of 15%, the $142,638 accruing to young Parkinson must be considered as a very good return on a $2000 capital investment. It looked like a real Horatio Alger story of business success.

There were some problems, as the examiners' report pointed out:

> Due to the fact that this advertising agency was not yet recognized by the American Newspaper Publishers Association, some newspapers refused to extend credit . . . and in two instances it became necessary for the Society to guarantee payment for advertising space to be used on its behalf.

One ad program handled by the agency was to stimulate rentals in the Fordham Hill housing project constructed by Equitable in New York City. The cost of advertising such rentals during a single year was 47% of the gross income of $350,000 from the rentals. Said the report:

> Only 79% of the Fordham Hill apartments were rented, notwithstanding large expenditures for advertising. Because of its importance, the examiners called this matter to the attention of the Superintendent of Insurance, who discussed the situation with members of Equitable's executive committee. As a result, the arrangement between the society and the advertising agency was promptly terminated and a satisfactory adjustment made in respect to pending work to which the society was committed.

While they were there, the examiners took the opportunity to look into a complaint from another company that Equitable, "impelled by competitive pressure," was in violation of a New York statute establishing minimum first-year premium rates for group insurance. The department reviewed the whole affair with Equitable and received assurances that "the society will in the future rigorously observe all of the provisions of statute."

The report also criticized Equitable's reluctance to name policyholders to its board of directors. The Insurance Department had earlier urged that more policyholders be put on the board. At that time, Equitable officers agreed. But four of the next seven directors chosen were not policyholders.

Continued the report:

> In the course of the present examination, the examiners requested that the officers explain this patent disregard by

them of their commitment. The explanation requested has not been received. Moreover, one of the directors who is not a policyholder was elected after the examiner's request for the explanation, thus indicating a further failure of the management to comply with its pledge.

As a result of the Armstrong investigation of 1905, all of the officers and directors of Equitable had resigned. This time only the chairman, Parkinson, was asked to resign—which he shortly did, despite his stubborn insistence that he would not.

And the men who were collecting from both McCarthy and Equitable—did *they* resign? Don't be silly. They were promoted. Warner H. Mendel, Equitable's associate counsel who had to give back his $30,000 McCarthy salary, is now the company's vice-president and general solicitor. Robert E. Benson, listed in the report as simply an employee, is now a vice-president. Perhaps the company concluded that having to give the money back was punishment enough.

Equitable ended up in the hotel business, having foreclosed on McCarthy's proud monument, the Shamrock Hotel in Houston.

Metropolitan Life also fell under McCarthy's spell, lending him $15 million of policyholder money on some first-mortgage bonds of the Texas Gas Corporation—which went into default barely nine months later. The bonds were to mature November 1, 1958; at latest report, the insurance company was still receiving something "on account." If your name's McCarthy, though, I wouldn't try to sell any bonds at One Madison Avenue. Metropolitan doesn't want to have to foreclose on any hotels. Its specialty is farm foreclosures. The Temporary National Economic Committee investigation turned up the fact that Metropolitan was operating more than 7000 separate farms it had acquired by foreclosure. In a single year, the committee reported, Metropolitan harvested fifty thousand bales of cotton, ten million bushels of corn, five million bushels of wheat, a million pounds of tobacco and six million pounds of peanuts. If some of the dividends you've received on your Metropolitan policies seemed like peanuts, perhaps it was only coincidence.

Early in 1962, Carrol M. Shanks, president of the second largest insurance company, Prudential, resigned when conflicts of interest were suggested as a result of a transaction in which Shanks put up $100,000 of his money and bor-

rowed $3.9 million from the Bank of America toward the $8.4-million sale price of the Timber Conservation Company. The remaining $4.4 million was put up by Georgia-Pacific Corporation, a large borrower from Prudential, of which Shanks was a director. I won't bore you with the details. The upshot of a lot of wheeling and dealing was that Shanks reportedly stood to benefit by some $400,000 over a period of several years from an arrangement which had the effect of reducing by that amount the taxes he paid on his $250,000-a-year salary from Prudential.

Claiming that the whole affair was "misrepresented and misunderstood," Shanks announced that "in the months following my highly publicized personal transaction with Georgia-Pacific, it became evident to me that I should ask for early retirement in order to be free to pursue business and public service activities which have long held personal interest for me. I wish more freedom of personal action than I believe is, in some circles, deemed proper if I remain president of the Prudential."

The *National Underwriter* observed: "It is reported that a majority of the Prudential board wanted Mr. Shanks to continue as president and tried to dissuade him from resigning but he felt that several members were so strongly opposed to his remaining that it was impossible for him to continue." Presumably some of the directors felt that the avoidance of $400,000 in taxes on his substantial salary was not the type of "public service activity" with which the president of the company should be identified.

Shanks was president of Prudential. Prudential loaned money to the Georgia-Pacific Corporation. Georgia-Pacific loaned $4.4 million dollars to its director, the same Mr. Shanks. Now, *whose* money would you say was loaned to Shanks? No, you must be wrong—insurance companies are not permitted to lend money to their officers. Besides, the state insurance department in Prudential-dominated New Jersey found that there was no violation of the law. However, as a direct result of *l'affaire* Shanks, the National Association of Insurance Commissioners sent out a strongly worded directive that all companies were to establish clear and unequivocal standards of conduct on matters involving potential conflicts of interest. Beginning immediately, the companies were advised, their annual report forms would contain this question, which must be answered affirmatively:

> Has the company an established procedure for disclosure to its board of directors of any material interest or affiliation on the part of any of its officers, directors, trustees or responsible employees which is in or is likely to conflict with the official duties of such persons?

There are some people naïve enough to think that officers and directors in positions of trust would establish and maintain these minimum standards of business morality as a matter of course, without waiting to have them jammed down their throats.

The latest issue of the *Spectator Year Book* (1961) lists the following as directors of the Prudential: Roy E. Tomlinson, Chester I. Barnard, Harold W. Dodds, Josiah Stryker, Franklin Conklin, Jr., Edward W. Sprague, Alexander C. Nagle, Morse G. Dial, Carl W. Badenhausen, Howard S. Cullman, Jess H. Davis, Mervin J. Kelly, Royal A. Schaaf, Sydney G. Stevens, Hobart C. Ramsey, Owen R. Cheatham, Edward J. O'Mara, Herbert M. Ellend, Donald C. Luce, Vincent P. Biunno, Monroe J. Rathbone, Charles E. Daniel, and Louis R. Menagh. (Menagh, who succeeded Shanks as president, has himself since resigned.)

What a pity we don't know which ones constituted the majority that, according to the *National Underwriter,* saw nothing wrong in Shanks' dealings and urged him to stay on.

Prudential rammed a bill permitting its "variable annuity," an investment plan lurking behind the false whiskers of an insurance policy, through the legislature in its home state of New Jersey. The Securities and Exchange Commission studied the plan and announced that it was a security subject to SEC regulation and to compliance with the various federal securities laws. Prudential didn't have as much influence in the U. S. Supreme Court as it had in the New Jersey legislature—the Supreme Court ruled that the SEC had jurisdiction. Next, Prudential asked for a number of exemptions from the necessity of complying with the federal securities laws. In rejecting the request, the SEC called Prudential's variable annuity

> . . . a subtle and obscure device [that] comes to light only after long and close professional analysis. Under the circumstances it is difficult to see how the ordinary investor can ever be made to understand the inequality and discrimination which he may be buying without thorough, far-

reaching disclosures to him which would be required under the regulatory supervision of the commission.

The company retorted that if it had to give people a prospectus, it would rather abandon the whole idea. Don't think that the several years' battle up through the Supreme Court hasn't cost Prudential's policyholders plenty. But the company would rather write the whole thing off than merchandise it with a written prospectus telling people what they were buying.

Wouldn't it be a good idea to have Prudential and all other life insurance companies give a prospectus on *every* insurance policy they sell? Considering the thousands of dollars you're putting into that life insurance policy, wouldn't you like to know a little more about it? Woudn't we *all* be better off if we knew what we were buying? The insurance companies insist that life insurance is an investment. Let's have them sell it like an investment, then—with a prospectus.

Other Abuses

In 1961, a federal grand jury indicted the president of Colorado Credit Life and five other prominent individuals associated with that company on charges of nine violations of the federal securities laws, one charge of conspiracy, four charges of mail fraud, and four charges of fraud by wire in connection with the operations of an insurance complex run by the group.

The same year, a leading Chicago newspaper ran a series of articles highly critical of the sales methods of the Commerce Insurance Company of Chicago. Michigan's Insurance Commissioner Colburn expressed the hope that high-pressure tactics can be "cleaned up within company ranks," but warned that if "companies do not handle the problem themselves, this department will crack down on them."

The abuse of the term "investment" is widespread. Missouri Insurance Superintendent Jack Clay is one of the few officials who is rigidly enforcing state laws which prohibit the sale of any insurance policy as an investment or the use of any similar designations which state or imply that a policy possesses investment characteristics other than those arising from the cash, loan, or settlement options.

A typical example of this sort of policy is Franklin Life's

PPIP—President's Protective Investment Plan. This designation is plastered in bold letters across the bottom of the contract. The smaller print discloses that it's just another 20-payment life policy—but with a gimmick. In addition to being participating (Franklin is a stock company), the policy contains a sheet of "guaranteed coupons," impressively engraved, which will be redeemed by the company for specific amounts during the 20-year premium-paying period. These guaranteed coupons are just like dividends, with the same options that apply to regular dividends. In other words, the company collects a premium from you and guarantees to pay a part of it back to you at the end of the year. What is the purpose of collecting it from you if the company does not have the use of it, cannot retain it, but instead must pay it back to you a year later? Since it is guaranteed, it obviously does not depend upon company earnings or mortality experience. Upon what, then, does it depend? What excuse is there for it?

Well, it helps to make the policy look like an investment. The policy may not *act* like an investment but the company leaves no stone unturned to make it *look* like one by dressing it up with a lot of coupons that may mislead the policyholder into associating them with interest payments such as are made to those who clip bond coupons.

As for the name "President's Protective Investment Plan," we can assume that the "President" part is just a puff for the High Lama. "Protective" probably refers to the reducing term insurance which the policy provides. But what does "Investment Plan" mean? Is a 20-payment life policy an investment plan? If it has been sold for years as a 20-payment life insurance policy, what was the motivation for relabeling it an investment plan? Does labeling it an investment plan make it one?

What would you say of a state insurance department which examined this policy and passed it for sale to the citizens of the state? Is it possible that it would never occur to the department that the designation "investment plan" was going to mislead the public?

Wisconsin recently banned such coupon policies. Said Commissioner Charles Manson:

> Coupon policy forms misrepresent, distort and disguise the true nature of the insurance being purchased. [They] are devised to give the appearance of the interest coupons

that are frequently attached to investment bonds. Although the coupon benefit is essentially a refund of premiums previously paid by the policyholder, it is frequently represented that it is the earnings or return on the investment of the policyholder in life insurance. [The coupon policy] has special characteristics making [it] peculiarly susceptible to misrepresentation and misunderstanding.

What motivates a company which aggressively merchandises a policy which "misrepresents, distorts and disguises the true nature of the insurance being purchased"? What is its true purpose in offering a policy calculated to mislead the policyholder into associating its coupons with bond-interest payments?

Justice Bergen of the New York Appellate Court, ruling that the superintendent of insurance of New York State could regulate group credit life rates, noted that

> A New York legislative hearing several years ago clearly established undesirable practices in this captive market and included the placement of credit insurance in excessive amounts and at excessive rates bearing no reasonable relationship to the benefits to be derived from such insurance.

The Minnesota Supreme Court once ruled that it was "an obvious and indefensible discrimination" against holders of certain types of policies for John Hancock to assess a surrender charge 40% higher on some policies than on others.

In 1962, the Pennsylvania State Insurance Department fined Knights Life $25,000 and cited two employees alleged to have bought answers to the license examination taken by 550 Knights Life agents. Licenses issued to the agents passing the examination were revoked and license fees amounting to more than $8000 were forfeited. Also in 1962, the New York State Insurance Department imposed upon the Credit Life Insurance Company (of Ohio) a fine of $13,000 for selling policies in New York without bothering to obtain prior approval from the department. An additional fine of $7000 was imposed on the company for violating Section 213 of the New York insurance law, which prescribes limits on commissions paid to agents.

Here's a press service story from Washington:

The Senate Rackets Committee heard charges today that the Occidental Life Insurance Company of California deceived labor unions whose health and welfare programs it insured.

The charges came from committee counsel Robert F. Kennedy amid allegations that insurance benefits to union members were reduced as a result of secretly paid commissions taken out of premiums.

John P. Dandy, a vice-president of Occidental, defended the Los Angeles company's practices but conceded the size of commissions had something to do with the size of benefits.

There was testimony about a $100,000 payment, described as a commission to Harry Wraith, Occidental's general agent in Oakland, Calif. The committee also has heard about alleged overcharges totaling nearly $500,000 by the Dearborn Insurance Agency of Chicago on union health-welfare insurance issued by Occidental.

The president of Crescent Life of Kentucky was accused of converting company funds to his own use in a stock-fraud scandal.

Richard Heins, professor of insurance at the University of Wisconsin, conducting research on the subject of life insurance company failures, found information "extremely difficult to obtain. Doubtless this is because the managements of insolvent companies feel that the details are better left to oblivion."

Comparing insurance company disasters with disasters at sea, Professor Heins reported that "the captains of sinking insurance ships could often be found to be first in the lifeboats or even drilling holes in the bottom of the ship."

Do these instances help establish a picture of the moral tone of some elements of the insurance industry?

People who buy General Motors cars financed through GMAC pay a premium for creditors group life insurance. The insurance is a very desirable form which protects the car buyer's family if he dies. It is underwritten by Prudential. But Prudential "kicks back" 15% of the premium to General Motors. Instead of charging a rate appropriate to the risk, Prudential deliberately overcharges by 15% and then pays off General Motors. If General Motors wants to add x dollars to the price of a car, it has every right to do so, and it is up to the

buyer to decide whether he wants to pay it. But I think that it is quite improper for General Motors and Prudential to quote him a price for insurance when they know full well but do not tell him that a part of that insurance premium is not a premium at all but a hidden sales charge paid by a car purchaser who thinks he is buying only insurance to protect his family. I think that it is reprehensible for Prudential to lend itself to the extraction of this extra sales charge from car buyers in the name of insurance protection.

When voices were raised in criticism of this odiferous arrangement, the *National Underwriter* editorially came to the defense of Prudential (July 1, 1961):

> Whether the "refund" to the lending institution in connection with credit life insurance . . . is a defensible practice is a question which may be debated in the future. But as long as the practice is universal, it is a shame to see the finger of scorn pointed at one of the most responsible . . . examples of it.

Pedestrians are "mugged" every day in large cities. The next time the law collars a couple of thugs who have been caught in the act and hauls them off to the pokey, they can just grin at the judge and say: "What are you getting all excited about, Judge? Mugging goes on all over now. It's universal practice."

Maybe this credit insurance racket *is* universal. I note that American Bankers Life sued the Ford Motor Company, the Ford Motor Credit Corporation, and Nationwide Insurance, charging "restraint of trade and commerce in that Ford forced dealers to sell only credit life insurance policies issued by Nationwide."

Maybe it *is* universal. Perhaps it is just a manifestation of the changing times and this renegade generation. Perhaps we should strike *E Pluribus Unum* from our coinage and substitute "I'm all right, Jack!"

Maybe we're wasting our time. Maybe we *can't* do anything about it. Let's try, though.

Chapter 4

Company Profits

WE HAVE seen that there are two kinds of insurance companies: stock companies and mutual companies. A stock life insurance company is owned by its stockholders. A mutual life insurance company is owned by its policyholders, at least in theory.

Obviously, people who buy insurance from a mutual company may reasonably expect that, as the owners of the company, they will end up paying less for their insurance than if they had purchased it from a stock company whose object is admittedly to make a profit for the stockholders. Mutual companies take advantage of this assumption and make it a practice to overcharge their policyholders on the grounds that the company may experience unexpected mortality reverses. If the feared reverses don't materialize, the companies will return the overcharge—or so they claim. Actually, they don't stress the overcharge angle much. The companies prefer to let the policyholders think that the "dividend" they receive is their share in "profits" of a purely cooperative enterprise.

The stock companies don't have to make any pretense that they're paying the profits to the policyholders. As noted earlier, for purposes of competing with the mutual companies who have educated the public to think that there is something magic in a life insurance policy "dividend," most stock companies sell a line of "participating" policies which pay dividends. The companies charge higher rates on these policies, refund the overcharge to the policyholder in due course, and let him think he's making money. He's happy—he's received a "dividend."

A little later we'll discuss these dividends in more detail. Right now, our interest is in the profits made by life insurance companies, both stock companies which pay those profits to their shareholders and mutual companies which go through the motions at least of doing the same thing for their policyholders. Actually the mutual companies pay over *part* of the overcharge and stow the rest away in something called "sur-

plus," which is supposed to be for the protection of policyholders. Makes the insurance "safer" and all that sort of thing.

From the mortality statistics examined earlier, we have reached the conclusion that someone is making a lot of money in the life insurance business. Who is making it—and how much?

Mutualization of Stock Companies

When you start a stock life insurance company, you pay in some capital, just as you would in any other corporation. Some companies are spanking new, others have been in existence for a long, long time. A not uncommon occurrence has been the "mutualization" of a stock insurance company. This generally has happened when a stock company has prospered and accumulated a great deal of money. The stockholders decided, or were persuaded, that they had already made enough on the deal and it would do them no harm to take their profit somewhere else.

A classic example of this is Prudential, which started as a stock company in 1873 with only $25,000 paid-in capital. In 1911, Prudential became almost completely mutualized. "Almost" because there were a few hold-outs among the stockholders who just wouldn't sell their shares to the policyholders. The last of these gave up in 1943, however, and the company then became completely mutual.

In 1879, a Mr. Robotham invested $2200 in Prudential stock. In 1911, he was paid a juicy $563,896 for his stock. A nice profit, don't you agree?

At the same time that Robotham invested his $2200, a 35-year-old policyholder could have bought a $6000 single-premium policy for the same $2200. Had he died in 1911, the same year Robotham received his $563,896, his beneficiary would have been paid $6000. Robotham's investment in Prudential stock returned him more than 200%, compounded annually. The policyholder's $6000 death payment represented a return of less than 2½% compounded annually, on the $2200 cost.

The policyholder had to die in order for the beneficiary to receive $6000. Yet the policyholder supposedly now owns the company that was owned by the stockholder.

How does that original $25,000 capital investment in

Prudential look today? Pretty good. After buying out the stockholders for $16.9 *million* in cash, the company now has assets and surpluses of more than $18 *billion!* "Backward, turn backward, O Time, in your flight"—make me a Prudential stockholder just for tonight!

If Prudential was making fabulous profits for its stockholders before they sold out, isn't it a reasonable assumption that it is now making those same fabulous profits for its policyholders? What? You say you're a Prudential policyholder? And you're getting only 2½% on your policy? Well now, that's peculiar, isn't it?

Take other examples. The original capital of $150,000 invested in Continental Assurance in 1911 has soared to $73.5 million.

Lincoln National Life's original capital was $110,300, in 1905. By the end of 1960, it had climbed to $193.7 million.

Profit Ratio—Stock Companies

Companies operate on a very thin ratio of capital funds to insurance in force and to total liabilities. Among the ten largest stock companies, for each dollar of stockholder capital there is approximately $53 worth of insurance in force and about $10 worth of liabilities.

Perhaps the life insurance business isn't as profitable as it once was. Maybe the stock companies aren't making those big profits, lately? Let's have a look at a few of them.[1]

Below are the names of forty companies each one of which in a single year, 1960, produced a net profit equal to its entire paid-in capital:

Company	*Paid-in Capital*	*1960 Profits*
American Life & Acc., Ky.	$1,050,000	$1,166,048
American Security Life	100,000	135,722
Atlantic Coast Life	103,850	126,759
Atlantic Life	1,000,000	1,912,207
Beneficial Standard	2,194,872	2,348,086
Central Standard Life	1,102,500	1,403,555
Coleman Life	25,000	38,730
Colonial Life & Acc.	531,600	658,850
Commonwealth Life & Acc.	400,000	549,416
Connecticut General	12,000,000	14,632,286
Empire Life	320,000	520,571

[1] Figures compiled from *Spectator Insurance Year Book (1961).*

Company	*Paid-in Capital*	*1960 Profits*
Farmers & Traders Life	$ 300,000	$ 577,522
Home Life of Amer.	750,000	775,500
Kansas City Life	4,000,000	4,549,038
Lamar Life	1,000,000	1,187,000
Lincoln Income Life	717,516	724,185
Lincoln National Life	20,000,000	26,821,922
Manhattan Life	2,200,000	2,489,475
Midland Empire Life	100,000	100,359
National Farm Life	100,000	106,171
National Public Service Ins.	357,332	358,822
National Reserve Life	420,000	530,382
Nationwide Life	2,400,000	2,399,918
Paul Revere Life	4,600,000	4,971,605
Pierce Insurance Co.	250,000	527,496
Pilgrim Health & Life	200,000	237,784
Pilot Life	5,000,000	5,109,077
Professional & Businessmen's	300,000	351,055
Pyramid Life	350,000	491,390
Service Ins., Ala.	213,500	286,157
Standard Life & Acc., Okla.	500,000	652,979
State Farm Life	3,000,000	3,142,169
State Reserve Life	250,000	323,221
Stuyvesant Life	500,000	537,623
Union Bankers	300,000	570,076
Union Life, Ark.	300,000	311,516
United Ins. Co. of America	6,000,000	6,261,070
United Services Life	800,000	1,342,109
Victory Life	200,000	242,557
Western General Life	100,000	144,465

Here are the names of ten companies. Each of these in a single year, 1960, produced a profit equal to *twice* its entire capital:

Company	*Paid-in Capital*	*1960 Profits*
Bankers Life & Cas.	$3,500,000	$7,896,949
Cavalier Life	2,500,000	5,078,814
College Life	265,000	629,545
Imperial Life	1,000,000	2,718,402
Mid-States Life	300,000	772,981
National Bankers Life	300,000	813,417
National Burial Ins.	220,000	614,821
Professional Insurance Corp.	250,000	550,688
Ranchers Life	100,000	224,559
Western National	300,000	734,337

Below is a list of nine companies whose 1960 profits alone were more than three times their paid-in capital:

Company	*Paid-in Capital*	*1960 Profits*
American Life & Acc.	$ 25,000	$ 92,191
Columbus Mutual	500,000	1,732,972
Crown Life	1,000,000	3,604,913
Dominion Life	400,000	1,551,566
Equitable of Iowa	1,000,000	3,671,827
Excelsior Life	250,000	858,078
Farm Bureau Life	212,190	804,192
Guarantee Reserve	458,330	1,776,112
Pacific Fidelity	500,000	1,547,403

Hold on now; here are four companies whose profits in a single year were more than four times their capital:

Company	*Paid-in Capital*	*1960 Profits*
Confederation Life	$1,000,000	$4,105,969
North American, Chic.	1,000,000	4,972,026
Rio Grande National	110,000	500,312
La Sauvgarde Life	238,000	1,015,517

Here are three who earned more than five times their capital in a single year:

Company	*Paid-in Capital*	*1960 Profits*
Canada Life	$1,000,000	$5,691,913
London Life	1,000,000	5,476,805
Reserve Life	1,000,000	5,066,595

One company earned six times its capital:

Company	*Paid-in Capital*	*1960 Profits*
United Benefit—Omaha	$1,000,000	$6,314,054

These two earned seven times their capital:

Company	*Paid-in Capital*	*1960 Profits*
Capital Life	$ 500,000	$3,784,271
Southern Farm Bureau Life	200,000	1,483,781

One of our neighbors to the north made a killing—ten times its capital:

Company	*Paid-in Capital*	*1960 Profits*
Sun Life of Canada	$2,000,000	$21,298,087

But the prize was shared by two companies which demonstrated free enterprise at its juiciest. In a single year, they earned a fabulous *twelve times* their entire paid-in capital:

Company	*Paid-in Capital*	*1960 Profits*
Security Life & Accident	$ 100,000	$ 1,203,100
Great West Life	1,000,000	12,198,200

As a matter of fact, these figures aren't accurate. Stock insurance companies make it a point to pay very little in cash dividends; stock dividends are their specialty. Most of the companies listed here have paid substantial stock dividends over the years. For example, Connecticut General's $12-million capital includes a $3-million stock dividend paid in 1949 and a $6-million stock dividend paid in 1956. A similar situation exists with respect to most other stock companies except those which are newly organized. If we were to relate the 1960 profits to the amount of money actually paid into the company by the stockholders, the results would be almost unbelievable.

Here's a sampling of some of the stock companies and the stock dividends they paid in 1961:[2]

	Stock Dividend
Franklin Life Ins. Co.	25%
Business Men's Assurance Co.	25%
Connecticut General Life Ins. Co.	100%
Continental Assurance Co.	50%
Gov't Employees Life Ins. Co.	50%
Liberty National Life Ins. Co.	33⅓%
Lincoln National Life Ins. Co.	2-for-1 and 25%
Monumental Life Ins. Co.	25%
National Old Line Ins. Co.	20%
United Services Life Ins. Co.	33⅓%
U. S. Life Ins. Co.	20%
Midwestern United Life Ins. Co.	20%

These were all stock companies. It is a simple matter to compare their capital investment with their current profits

[2] Compiled from *Spectator Insurance Year Book (1961).*

and thus determine just how profitable the life insurance business really is.

Profit Ratio—Mutual Companies

Mutual companies have no stockholders to share their profits. That doesn't mean that they don't have any profits, though. The mutuals supposedly pay profits out as dividends. In actual practice, a good part of profits is directed instead into "special" and "unassigned" surplus whence they may never return. The excuse for surplus is that it makes the policyholder's insurance that much "safer." We will discuss the surplus and its uses presently.

Just to give you an idea of the profits earned by mutual companies, even after paying for those gorgeous palaces "soaring 42 stories to the sky," let's look at the 1960 figures for six of the better-known ones:

Company	*Net Gain after Dividends*
Metropolitan	$ 76,535,435
Prudential	112,361,204
Equitable	41,344,365
John Hancock	33,097,190
New York Life	16,607,415
Northwestern Mutual	13,434,116

In the past few years, a full realization of the incredible profits to be made in the life insurance business has come to the investment community and the sale of shares in stock life insurance companies has boomed. Let's look at some typical figures. Here's what a 1951 investment of $1000 in the stock of some of the leading companies was worth in 1961:

Franklin Life	$31,830
U. S. Life	28,880
Liberty National	23,710
Business Men's Assurance	23,340
Bankers National	11,340
Connecticut General	5,660
Travelers	3,650

The boom is gathering momentum. Here are the increases in the prices of some life insurance company stocks in a single year, 1961:

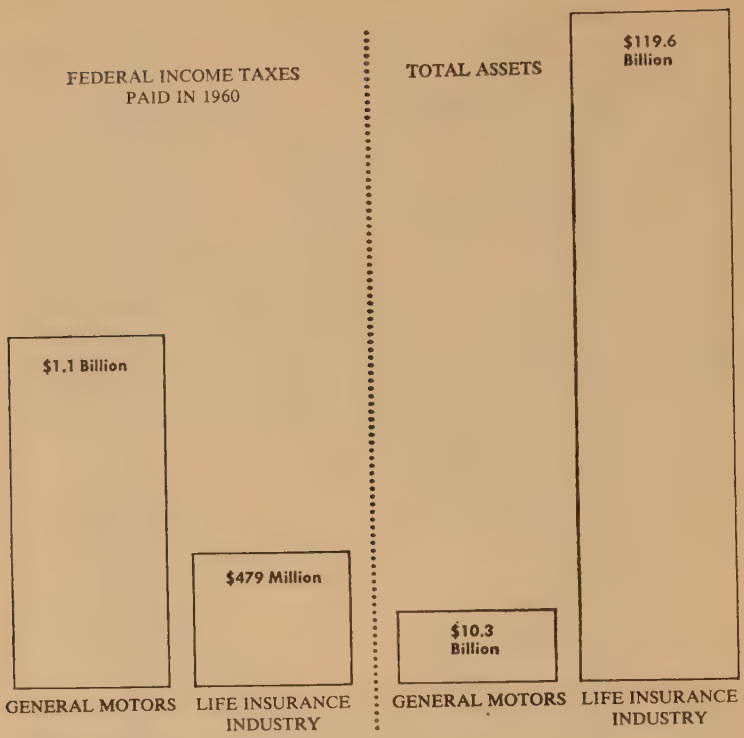
Company	*% Gain*
Am. Life, Ala.	556
Eastern Life	471
United Services	258
Old Line Life	250
All-Am. Life & Cas.	247
Government Employees	240
Banlife Corp.	231
Citizens Life	222
Bankers National Life	218
B. M. A.	216
Security L. & A.	215
Fidelity Bankers	210
Cal.-West. States	190
Continental American	188
Republic Nat. Life	184
Commonwealth Life	181
Beneficial Standard	179
Georgia International	178
Interstate Life & Acc.	174
United Am. Life, Colo.	174
Life of Georgia	172
Crown Life	169
United, Ill.	165
Postal Life	163
Provident L. & A.	157
Lamar Life	155
Liberty National	154
Midwest United	153
Liberty Life	150
Occidental, N.C.	148

Tax Advantages

The government has traditionally provided life insurance companies with special tax treatment. As a result, revenues which in other businesses would be swept away by taxes are retained and compounded to increase earnings for the stockholders. Chart 1 relates the tax bill of the insurance industry to that of General Motors Corporation, disclosing the extent of this tax favor.

As a result of this favor and of discriminatory accounting practices which life insurance companies are permitted, the industry enjoyed the largest profit increase of any American industry in 1960. Directly or indirectly, Uncle Sam gets very little of the profit.

CHART 1



As the word of the insurance bonanza spread, a few shady operators moved in. Dozens of new companies have been spawned, their stocks touted by brokers who specialize in insurance stocks. One big New York Stock Exchange firm has been sued for $58,000 in connection with its sale of stock in a life company not licensed in New York. State law there prohibits sale of the stock of such companies, but enforcement has been lackadaisical.

An item in the Chicago *Sun-Times* calls attention to "one of the problems arising from the weed-like growth of new life insurance companies in Illinois, the sale of stock in nonexistent companies." Pointing out that more than a dozen life companies were chartered in Illinois during the preceding year and that salesmen had been imported into the state to get the stock distributed among the citizens, the story con-

tinued: "With the original stock issue out of the way, the salesmen found themselves out of work so they got together and promoted some of their own so-called insurance companies. Illinois Securities Commissioner Donald L. Calvin says that of the salesmen his department could lay its hands on, not one had registered to sell securities within the state nor did the companies have assets justifying authorization to sell in Illinois. 'A serious problem,' said Mr. Calvin, 'which is giving the insurance business a black eye.'"

Insurance companies like to hide their profits. Vice-president Raymond T. Smith of Best's, in his book *Life Insurance Stocks,* says: "The true earning power of a life insurance company is understated in year-end reports. . . . Nearly all companies follow the policy of retaining the greater part of earnings to finance expansion as well as provide an extra margin of protection for shareholders."

Speaking to the Investment Analysts Society of Chicago, Smith noted: "Shares of well-managed, aggressive life insurance companies have done twice as well as the blue chip industries in the past ten years."

A significant fact is that most of the profits are *retained to finance expansion.* Just tuck this away in your mind and we'll get back to it shortly.

Efficiency

First, let's take a quick look at the operating efficiency of stock versus mutual companies as reflected in the expenses of companies which are comparable in size.

Here are the admitted 1960 operating expenses of two companies each with approximately $26 billion worth of insurance in force:

Travelers (stock company)	$ 48,556,763
John Hancock (mutual company)	155,297,215

Here are the 1960 operating expenses of two companies each with approximately $24 billion worth of insurance in force:

Aetna Life (stock company)	$ 99,538,447
New York Life (mutual company)	173,591,521

Here are the 1960 operating expenses of two companies each with approximately $7 billion worth of insurance in force:

Continental Assurance (stock company)	$ 31,111,864
New England Life (mutual company)	46,075,232

Here are the 1960 operating expenses of two companies each with approximately $3 billion worth of insurance in force:

California-Western States (stock company)	$13,931,428
State Mutual (mutual company)	23,660,332

Here are the 1960 operating expenses of two companies each with approximately $2.4 billion worth of insurance in force:

Northwestern National (stock company)	$13,654,934
Phoenix Mutual (mutual company)	18,915,270

And finally, here are the 1960 operating expenses of two companies each with approximately $1 billion worth of insurance in force:

Cavalier Life (stock company)	$3,736,076
Union Mutual (mutual company)	7,010,131

With approximately the same total insurance in force, the six mutual companies had $424,549,701 of operating expenses versus the $210,529,512 of the six stock companies. The stock company officers had to account to their stockholders. The mutual company officers, accountable to no one, had a field day with the policyholders' cash. As you ponder these figures, you might bear in mind that the 153 mutual companies account for more than 63% of the total insurance sold.

Going back to Raymond Smith's *Life Insurance Stocks*, we discover how significant to company profits are even small differences in premiums:

> Premium rates [of different companies] per $1,000 of identical coverages issued at identical ages vary slightly. But fifty cents or a dollar differential per $1,000 in the

aggregate represents a substantial difference in overall earnings. For example, if claims, reserves, and expenses amount to $27 per year, a policy with a $30 premium has a profit rate of $3 per year. An identical policy, with a premium rate of $31, earns $4 a year.

Thus we see that even small, seemingly inconsequential differences in cost can make differences of millions of dollars in company profits.

Regulation

Let me say again that I'm all for free enterprise. I see no objection whatever to a stock insurance company which is frankly organized for profit making that profit. I say very emphatically, however, that in the case of a mutual company, the participants should actually get the profit in the form of a reduced cost for their insurance, not as phony "dividends" which are merely refunds of overcharges. Equally important, both stock and mutual companies should be required to sell life insurance at rates based upon realistic mortality tables.

There is an inherent tendency for government administration to be inefficient and wasteful. I am certain, though, that the government could provide a federally operated life insurance system which, however wasteful and inefficient it might be, could furnish the same life insurance protection at a far cheaper rate than that charged by the stock and mutual companies of the country. The industry is failing the American people. If it cannot be persuaded to clean house, if the lesson of the Armstrong investigation was entirely wasted on it, then let us have federal life insurance with mortality tables updated each year.

Many years ago, Supreme Court Justice Louis Brandeis condemned the inequity of our life insurance system and led a protest move which resulted in the introduction of savings-bank life insurance in New York, Connecticut, and Massachusetts. Limited amounts of low-cost life insurance can now be obtained in those states at rates far below those of commercial companies. The banks may not feature luminous ceilings, teakwood, and abstract impressionist paintings—they just sell cheap insurance. The giants look down their noses at the savings banks and sneer that they sell as much new insurance in a single month as the savings banks have sold in all the years since they began their insurance operation.

The giants might add that they have also lapsed more insurance than the savings banks have written.

Frankly, I don't think savings banks ought to be in the life insurance business. I think that they should stick to the banking business, just as I shall shortly explain why I think life insurance companies have no business in the banking field—as they *are* with both feet. I'm all for having the shoemaker stick to his last. But the savings banks in three states have given a small segment of the public limited relief from the depredations of the commercial companies. They have shown that it can be done.

The answer is not to extend savings-bank distribution of life insurance throughout the country. The answer is to clean up the commercial companies. If this cannot be done, then perhaps life insurance should be made a governmental function like Social Security.

The life insurance industry isn't going to give up anything voluntarily. Robert B. Mitchell, editor of the *National Underwriter,* interviewing Louis W. Dawson, retiring chairman of Mutual of New York, reported:

> Here are Mr. Dawson's views on some other problems I asked him about:
>
> Price revision of the life insurance product: This is about at its end. Margins have been reduced about as much as they can be. The reductions came about because many companies had greater margins than they needed. As interest levels and mortality improved, actuarial studies showed that these could safely be decreased. It would be a sad mistake to go on cutting margins blindly. This could lead to trouble and introduce a risk situation that has not been present thus far.

Surplus

You'll remember that the insurance expert, Raymond Smith, noted that "nearly all companies follow the policy of retaining the greater part of earnings to finance expansion as well as provide an extra margin of protection." They retain it by putting it into "surplus."

The *1961 Spectator Year Book* discloses that Dawson's company, Mutual of New York, has unassigned surplus of $209,017,141. This is the profit from its operation which it

has retained and accumulated after supposedly distributing the net profits from its operation to the policyholders in the form of dividends. In 1960, the company paid its agents $16.5 million in commissions. Additionally, it had "general insurance expenses" of $38.3 million and another $43.2 million in "miscellaneous expenses." Dawson says "Margins have been reduced about as much as they can be."

The huge profits promised by the promoters of the sale of shares of stock in life insurance companies cannot materialize without continuing the undesirable practices which exist in the industry today.

Chapter 5

Company Investments

WHAT DO life insurance companies do with the money they collect from policyholders? They invest it.

Their investments are many and varied.

The 1960 *Life Insurance Fact Book* states that "a policyholder whose share of life insurance funds was $1,000 might be said to have the following portfolio:

$243	in home mortgages
$157	in public utility bonds and stock
$151	in automobile, textile, food, machinery and other manufacturing industry bonds (including $50 in oil and chemical bonds and $9 in shipping)
$ 81	in commercial mortgages (including $12 on shopping centers and $3 on churches)
$ 73	in wholesale, finance, service and other non-manufacturing industry bonds (including $7 for conversion to jet planes)
$ 54	in U.S. Government securities
$ 44	in loans to policyholders
$ 38	in municipal bonds (including $6 for public schools and $12 for bridges, roads and tunnels)
$ 32	in railroad bonds and stocks
$ 31	in real estate
$ 25	in farm mortgages
$ 71	in other investments"

There is a clear inference here that ownership of a life insurance policy is a form of indirect ownership of a portfolio of stocks, bonds, etc., with all of the benefits which might normally be expected to accrue from such investments.

Invariably, the life insurance industry stresses in its "hard sell" that investment by the individual on his own is always speculative and almost always results in heavy financial loss to him. The question of what the life insurance company does with the policyholders' money is seldom raised by the sales-

man. Occasionally, in a propaganda piece such as the *Fact Book,* it will be suggested that in some mysterious way the life insurance policyholder is able to enjoy the fruits of investing without taking any of the risks.

The suggestion that a policyholder with $1000 in cash value has a "portfolio" such as that suggested above by the *Fact Book* is, of course, completely misleading. There *is* an investment portfolio. The money *is* put to work as they show it to be. But the profits do not go to those whose money did the work. The profits inure to the benefit of the insurance companies—to the stockholders in the case of a stock insurance company and to that great financial graveyard, the surplus, in the case of a mutual company.

Twenty years ago, the Twentieth Century Fund, an endowed foundation founded by Edward A. Filene, studied the life insurance industry and published its conclusion that the industry should adopt a bolder investment policy. Foreseeing the inflation that lay ahead, the foundation pointed out that the millions of owners of cash value insurance were destined to suffer immeasurably unless their insurance funds were employed more productively on their behalf. At that time, it was the practice to restrict life insurance investments almost entirely to debt securities. The insurance industry should invest more in common stocks, observed the foundation, with a view to giving the policyholders a larger return on their "investment" in life insurance. I recall pointing out to the Twentieth Century Fund at the time that the insurance industry might eventually get to the point of putting some of its assets into common stocks, but that it would never bring itself to permit the larger profits which would result from a more liberal investment policy to trickle down into the pockets of the policyholders. The increased income and profits would simply go to build bigger surpluses and the policyholders would not be one whit better off.

This is approximately what has happened. The life insurance industry now has more than $5 billion invested in stocks. Its holdings of industrial stocks have increased 50% in the past two years, doubled in the past eight years. The *Life Insurance Fact Book* says: "Common stocks have had an increasingly important role in the life insurance companies' investment program during recent years."

Raymond T. Smith, Best's vice-president, in his book, *Life Insurance Stocks,* says:

Many earnings-conscious managements believe that when investing a large portfolio, a certain percentage of total assets should be invested in opportunities for capital gains. While not considered by some to be current earnings, nevertheless they are a definite source of gain to the stockholders and progressive managements today are investing assets with an eye to such gains.

While it is true that life companies are broadening their investment policies, I still think it improper to imply that policyholders are owners of specific securities held by the companies.

An amusing incident comes to mind. Among my clients was a local chapter of the Women's Christian Temperance Union. I well remember the consternation of the group when I mentioned to them that the New England Mutual Life Insurance Company, in which several of them had policies, had loaned nearly a million dollars of the policyholders' money to finance Drewrys Limited, a large Midwestern brewery.

An interesting sidelight on insurance-company investments may be gained from the following figures, indicating the trend of the industry's investment in U.S. government securities:

1946—$21.6 billion	1951—$11.0 billion	1956—$7.5 billion
1947— 20.0 "	1952— 10.2 "	1957— 7.0 "
1948— 16.7 "	1953— 9.8 "	1958— 7.1 "
1949— 15.2 "	1954— 9.0 "	1959— 6.8 "
1950— 13.4 "	1955— 8.5 "	1960— 6.4 "

Considering that their assets increased 2½ times in that period, the dollar decline is even more significant. In passing, let us contrast it with the trend of their recent holdings of foreign government securities:

1958 — $320 million
1959 — 349 million
1960 — 437 million

Investmentwise, the insurance companies have their share of lemons. There are few companies without some defaulted bonds. The Connecticut Mutual Life of Hartford took about

half of a $1,970,000 bond issue, the proceeds of which were used to build a bridge across the Missouri River between Nebraska and Iowa. The bridge was built, but the river then perversely decided to flow elsewhere. Obviously trying to be helpful, five Republican Congressmen from Connecticut sponsored a bill to appropriate $2,200,000 to put the river back under the $1,970,000 bridge. Congressman (now Senator) Thomas J. Dodd of Hartford, the insurance capital of the world, in a refreshing display of political daredevilry, voted against it. Finally, Army engineers managed to get the river back under the bridge for a mere $550,000.

Not all the investments are in securities. Sometimes the companies buy real estate for investment. Equitable Life built a huge apartment project in New York City at a cost of $18 million. Four of the most inflationary years in our history later, it sold the project for $16 million.

Insurance companies aren't as partial to farm mortgages as they used to be. In 1939, they owned 15% of the State of Iowa as a result of wholesale foreclosures during the depression years.

What do insurance companies do with your money that makes it so "safe"? They invest it.

Do they have some magic wand to wave over their investments that makes them safer? I think not.

American life insurance companies own $5 billion of common stocks—and they are buying more every day. A *New York Times* article reported that "the investment policies of the insurance companies tend more and more to parallel those of the mutual funds." What makes General Electric stock safer when it is owned by an insurance company, which gives you a little bit of interest and keeps the profit, than when it is owned by a mutual fund, which gives you the profit?

Life Insurance as Old Age Insurance

Let's face the fact that unless you're a loan shark, you'll never get anywhere lending your money at interest—even to an insurance company. The American people have made more money than anyone else in the world. And they've saved it—the savings banks, postal savings, building and loan associations, and insurance companies are bulging with cash. Billions in savings bonds are outstanding. Yet today we require a Social Security Act to take care of us when we're 65 years old.

Why this curious economic paradox? Why, if we have made all that money and saved it, do we need this dole in our old age? The answer lies in the miserably small return we have gotten on our money. At the rate of return paid on a cash value life insurance policy, even if carried to maturity, we cannot accumulate enough to let us sit back at age 65 with our financial independence and our self-respect intact.

The great fortunes in this country were not made by lending money to insurance companies. These fortunes grew, in most instances, from investments in American business and industry.

Roger Hull, president of Mutual Life of New York, sounded the keynote of the insurance company's viewpoint on investment:

> The average individual without any special investment knowledge or ability is not likely to invest his funds as well as a life insurance company can do it for him.

You will observe that Mr. Hull, speaking of the policyholder, asserts that he cannot invest his funds "as well as a life insurance company can do it for him." Actually, of course, the life insurance company is not investing his funds *for him;* it is investing them *for itself* and paying him, at most, a tiny rental for the use of his funds. If it were investing *for him,* he would be sharing in the huge profits of the life insurance business which were dètailed in the last chapter.

Insurance companies aren't satisfied to sell you protection. They want more than the premiums for protection; they want your whole income. They pat you on the head as if you were a small and not-too-bright child and patiently point out that you don't know anything about handling money and you'll undoubtedly end up by dropping your whole packet at the track or in the market. "Don't take a chance, Joe," they say. "Send it all to us. We'll take care of it. It'll be safe, Joe. Just think of it—protection for the little woman, education for the kids, and in the sunset years when you reach age 100 and this policy matures, you can sit back and really enjoy life. Send it along to us, Joe. Don't take a chance." As a *coup de grâce,* the agent reaches into the closet and gives the skeleton of the '29 market crash a good rattle, and the deed is done.

A surprising number of Joes do "send it along." Perhaps it is a reflection of this generation's veneration for security.

The willingness to take the risks of equity ownership goes hand in hand with progress. Dr. Marcus Nadler, in the Hanover Bank's *Security Markets,* observed that where people refuse these risks and prefer to invest only in high-grade fixed-income-bearing securities, the economy of the country is bound to stagnate.

Millions of American families cannot participate in the growth of the country because they depend upon life insurance as a financial way of life. This is a tragedy for them and for the country.

Professor Domenico Gagliardo of the Economics Department of the University of Kansas, in a survey of the financial status of people over 65 in this country, found that of those who were financially independent, only 7% owed their independence to life insurance or annuities. A total of 93% were self-supporting because of current income from savings, real estate, and securities.

For more than a hundred years, life insurance has represented itself as a savings-and-investment plan. Do not these statistics prove beyond any doubt that it has been a dismal failure? In view of the staggering price the American people have paid over the years to learn that life insurance is not a good investment, should not the industry now abandon its pretensions in this area and devote itself exclusively to providing protection—*maximum* protection, that is—at minimum outlay?

Life insurance companies constantly claim that the American people simply will not save on their own. This is ridiculous. Here is a record of the money that was *saved* in 1960:

Savings and loan shares	$ 7,600,000,000
Commercial bank savings accounts	4,600,000,000
Mutual savings bank deposits	1,400,000,000
Credit union deposits	500,000,000
Total	$14,100,000,000

We haven't included the millions who *invest* on their own or through mutual funds.

Who says that the American people will not save unless an insurance company takes the money away from them? The savings recorded above were *real* savings, subject to the savers' call at any time. The money which was saved and in-

vested in life insurance does *not* belong to the savers and is therefore not true savings. Today, most insurance policies have a built-in six-month moratorium on payment of cash values. Without regard for the relative profitability of a separate savings program or investment (which we will explore presently) it just doesn't make sense for a man to tie himself up in the submarginal savings plan called "permanent, cash value life insurance."

Chapter 6

The Moratorium

SOME OF THE people are catching on.

A decade ago, the average annual premium for life insurance was close to $30 per $1000. It is now down to $20. This has not been due to any wholesale reduction in rates but rather to increasing selectivity on the part of the insurance buyer. The people who once bought high-premium policies which provided little protection for their families are now beginning to seek low-cost protection so that premium dollars will buy more actual insurance.

The decrease in the average annual premium has cut into company income and agent commissions alike. To counter this trend, the companies have begun a vigorous campaign to sell "living insurance." By this they mean insurance which not only provides protection but also builds substantial cash values which may be drawn upon as "living" benefits.

As a part of the campaign to sell "living insurance" and thus boost the average premium, the companies have increased their emphasis upon life insurance as an investment, comparing it with other media of investment and savings. Their principal sales argument revolves around the question of safety. Ever since the 1929 crash of the stock market, insurance salesmen have talked endlessly about the danger of investment in securities and have eulogized the safety of life insurance. Insurance was the only thing which came through the Depression unscathed, they report.

This is an interesting subject, one to which we might give our attention briefly. Did life insurance prove to be the only safe thing in the Depression? Or did it experience difficulties; and if so, what were they? Most important, have the things which caused the difficulties been eliminated? We are not interested here in ancient history. Our interest is in life insurance today. But if there have been times in the recent past when the safety of life insurance was tested and found wanting to any degree, it is fair and reasonable for us to examine the reasons for its earlier failure to reassure ourselves that they no longer exist.

In 1929, approximately 300 life insurance companies were in business. By 1936, 14%, or more than 40 companies, had gone through receivership. Some were small companies with less than $50 million worth of insurance in force; others were large, and one had more than $1 billion worth of insurance in force.

Best's *1940 Life Insurance Reports* (pages viii and ix) supplies the information that American policyholders lost $200 million as a result of the failure of insurance companies in the '30s.

Of the 14% of the companies in the industry which went into receivership during that trying period, *not a single one failed because of its life insurance operations.* In every single instance, the failure was due to the banking and investment operations of the company. Every company which failed, with consequent loss to the policyholders, would have come through the Depression without difficulty if it had stuck to the insurance business and stayed out of the banking and investment business.

Policy Reserves

Life insurance companies must accumulate and employ productively the premium dollars which are paid in advance for level-premium-system life insurance under which a policyholder pays higher-than-needed premiums during the first half of the policy's lifetime in order that he may pay lower-than-needed premiums during the second half, when the true premium might become prohibitively high for him at his then-older age. The advance premiums thus paid become part of the company's assets. The amount thus set aside for the account of a specific insured person is said to be the "reserve" on his policy.

Most policies provide for the accumulation of a cash value which, if the policyholder lasts long enough, will eventually be paid to him as an endowment. For this "living" benefit he pays extra premium dollars over and above the cost of insuring himself. These dollars, too, are set aside in his policy reserve—and right here is the root of all the troubles of the more than 14% of the industry which failed in the '30s. The sole purpose of life insurance is to provide protection. It was never intended to be an instrument for the *accumulation* of an estate. A life insurance company is not a savings bank and should not be permitted to assume the characteristics of one.

By claiming for life insurance the characteristics and advantages of a savings-and-investment plan, the industry has undoubtedly been able to sell policies to people who had no need for the protection or who felt that they had adequately met the need. By the same token, it led itself to the brink of ruin in 1933—*and it may do so again.*

The policyholder who has used life insurance to accumulate money in, for example, a 20-year endowment is privileged to call upon his policy's reserve. If he had accumulated the money in a savings bank, he could go down and draw it out when he needed it. Similarly, if he has used the insurance company as a savings bank, he is permitted to draw upon his reserve. (The disadvantages of the insurance type of savings account will be discussed later.) Of a policy's total reserve, the savings-account part is by far the greater. The advance premiums are a minor factor.

When people get into financial difficulties, they go to the bank and draw money out of their savings accounts. If they are persuaded by a life insurance company to use it as a savings bank, large numbers of them will wish to withdraw their savings accounts from the insurance company in a time of financial stress.

The Society of Actuaries recognizes that the life insurance industry is treading upon dangerous ground when it engages in the demand-banking business. In its proceedings, we read:

> As any life or endowment policy involves an investment or savings element, a life insurance company performs some of the functions of a savings bank and, to a smaller degree, of a commercial bank. This banking function must be recognized, defined and controlled in such a way that it will never endanger the insurance function.

In 1931, the Depression was well under way. Millions were unemployed. Those who were not saw their incomes drastically reduced.[1]

[1] We are speaking here of the people employed outside the life insurance industry. Insurance executives didn't know there was a depression. In this difficult year, for example, the president of New York Life had his salary increased from $100,000 to $117,000. The following year, while the nation—and the policyholders of New York Life—gasped for economic breath, his salary was raised again, to $125,000.

People who had lacked the foresight to become insurance-company presidents were hard-pressed. In 1931–32, millions of policyholders found it necessary to call upon the savings accounts which they had earlier been persuaded to establish with the life insurance companies. All insurance contracts then contained a contractual commitment by the company to pay the cash or loan value on demand. The companies found it increasingly difficult to meet demands for cash from people who wanted to terminate their policies or borrow against them.

Insurance Company Failures

Unable to pay off, weaker companies began to go into receivership. The life insurance industry, which had promised to pay the savings-account money on demand, found that it could not do so. In this respect, it was in much the same position as countless banks whose assets were frozen. Unable to pay off, the banks closed, and many a respected bank president lived out the rest of his life in disgrace because his institution had not been liquid and because the securities it owned or held as collateral had shrunk in value.

Not so the insurance companies. In February 1933, an unpublicized meeting of life insurance company officials was held in New York. Present were one or more of the principal executives of all of the big Eastern companies as well as many of the smaller companies. Also present as observers were the insurance commissioners or deputy commissioners from 19 states. The insurance men laid it on the line. The life insurance industry could not meet its obligations. It could pay death claims and matured policies but it just could not raise the money to pay the cash and loan values for which it was contractually obligated under the millions of "savings account" policies it had sold. Furthermore, like the banks, its invested assets had shrunk in value by reason of the decline in security prices to the point where company financial statements would show those assets to be below the amounts required by law to support their reserve obligations and they would all, from the greatest to the smallest, be declared insolvent and forced into receivership. The possible disastrous results of this to the country were beyond comprehension, they pointed out to the commissioners. Life insurance was

the foundation of the personal security of every American family. If it went under, the nation would be thrown into a state of financial anarchy from which it might not recover for generations. If the companies' assets had to be sold in connection with the receivership, the dumping of these additional masses of securities onto the already depressed investment market would smash the modest recovery movement which had quietly begun in July 1932.

An actuary, James P. Sullivan, has written of the meeting:

> Finally one company executive offered a resolution requesting the State Insurance Commissioners to declare a moratorium on all policy loans and cash surrender demands. This was immediately seconded by another company executive and being put to a vote was adopted with but one dissenting vote. It was eloquent indeed of the distress under which all the companies, one possibly excepted, were laboring in their efforts to make good on their "banking promises." Their life insurance promises were causing them no trouble whatever.
>
> In spite of the practically unanimous request of the companies for this astounding help, the commissioners did not dare to declare a moratorium. Its illegality was unquestionable and the commissioners did not care to be responsible for initiating it. Matters dragged, with conditions growing more precarious daily. Then came the miracle; the banking moratorium was declared, temporarily closing all the banks in the country. Here was indeed the opportunity. It was immediately grasped by the companies, acting through the commissioners. Since the banks were given the benefit of a moratorium, and since the life insurance companies were really banks, naturally they should also have the benefit of a moratorium. Thus, within a day or two of the banking moratorium declared by the Federal government, we had the life insurance moratorium, put in force by the insurance commissioners of the various states. That night, life insurance executives who had not slept well for weeks had their first surcease from anxious worry; it seemed as though the punishment for their sins of high pressure banking was to pass them by, leaving them unscathed. Former officers of weak companies which had gone broke and been put into receivership before March

1, 1933, wept over the fact that the moratorium had not come sooner, or that they had not been permitted to operate until they too could come under its protecting cloak.

In order that another moratorium to save a future day of reckoning may not be counted on, it is well to pause and consider the kind of moratorium which the life insurance moratorium was. It differed in two very important respects from the banking moratorium. When the bank's paying tellers put up the "closed" sign, at that same instant the receiving teller's window was also closed. No banker dared to accept another dollar of deposit until his bank was again open to pay its obligations; the fear of Leavenworth or Atlanta kept the bank's receiving teller's window closed until the paying teller's window was open again. But it was not at all that way with the "life insurance" bank. Without even a moment's interruption, the life insurance bank continued to accept deposits, continued to solicit new deposits from old customers; it even continued to pay high commissions to agents for inducing new depositors to deposit their savings with the concern which was not paying its old depositors. The "life insurance" banking concerns even went so far as to threaten to forfeit the life insurance protection of old depositors who did not continue to make new deposits as their coming premiums fell due; and they did actually cancel many millions of dollars of life insurance in the six months from March to September 1933; all this was done in spite of the fact that the paying teller's window remained closed. Certainly that was a far different moratorium from the short one of a week or so which protected the regular banks. And certainly he would be an incurable optimist who could today anticipate that such assistance will ever again be given in any time of pressure.

The second point of great difference between the banking and the life insurance moratorium was the period of time over which they extended. Within a week or so, the banking moratorium was off, and both the receiving teller's and the paying teller's windows of the regular banks were doing business as usual. But the paying window of the life insurance bank remained closed for six months or more.

Unquestionably, the life insurance moratorium was illegal; no court in the land would have upheld it. Many thousands of buyers got back their savings in full right in

the midst of the moratorium by the mere threat to start court action if the companies didn't pay. No company wanted to defend the scheme in court where the sanctity of contracts would be upheld. The company which today expects that it may again be saved by a moratorium in the next period of inflation or deflation, boom or panic, is relying upon a very slender reed. A bank moratorium as an excuse is not at all likely again with bank deposits insured by a Federal agency. The giant life insurance companies are too full of purely bank deposit money to be able to rely with any degree of confidence on the saving grace of another moratorium in time of need.

Prophetically, Actuary Sullivan concluded:

> We feel that we must warn the company managements that their troubles are not yet over, nor even much alleviated. From our present condition we shall move on to either a boom or another depression; either inflation or deflation lies ahead. Inflation will produce an enormous demand for cash from those who in the past have used the high cash value policies as instruments of hoarding and tax dodging.
>
> Deflation will produce an enormous distress demand similar to that of 1931–33. In either case, the situation of the life insurance bank is bound to be precarious, speaking mildly, except for those companies which are really trying to get out of the bank—cash value and annuity—business at the same time that they are trying to sell more pure life insurance policies, at low rates, containing no cash value obligations. When the next period of stress arrives that company will be in the best situation which has the greatest proportion of its outstanding policies on the low-rate term plans, with little or no cash values.

F. M. Hope, Occidental Life's vice-president and actuary, wrote in an article in *Best's Insurance News:*

> If the growth of assets and their interest-bearing obligations is . . . holding back progress toward adequate insurance of the nation under the voluntary system, why not cut the Gordian knot? Why not sell fewer of the investment types

of policy and emphasize more the scientifically devised protection forms . . . and pure income replacement policies?

Built-in Moratorium

Appreciating that they would never again be able to blackmail the commissioners into a moratorium, the companies now issue policies with a built-in moratorium—the company may defer the payment of cash or loan values for six months. This is never explained to prospective purchasers, however, who are still led to believe that they may get their cash on demand. In addition, some of the largest companies have a further hedge clause: the insured may apply for the cash value only when a premium is in default. This is patently discriminatory; the man who pays premiums monthly can default in his next monthly premium and thus become entitled to ask for the cash value, while the man who pays premiums annually can only "qualify" for his cash value once a year. The companies know that this preposterous arrangement would never hold water and when confronted with the policyholder's demand, they always indicate that they are "willing" to waive the requirement.

Getting back to the moratorium, Actuary Sullivan's appraisal of its illegality seems sound. Assuming that the ukase of the individual state commissioners had the effectiveness of law, it should be considered in the light of Article I, Section 10 of the Constitution, which affirms "No state shall pass any law . . . impairing the obligation of contracts."

A few years after the moratorium, another actuary, Henry Moir, writing in the *Transactions of the Actuarial Society of America,* said:

> It should not be necessary for the insurance commissioners to come to the rescue of the insurance companies as they recently did. We should pay out to our withdrawing policyholders a less sum than the actual and true reserve on the individual policy. In other words, I strongly believe in adequate surrender charges much larger than we now impose and continuing during the duration of insurance, so that if there is a "run" for loans and surrenders, the surplus position of the company may thereby be improved and any losses from forced liquidation of bonds and other assets may be offset.

How typical this is of the thinking of most insurance men! They insist upon being in the demand-banking business but they don't want to accept the obligations of that business to return savings deposits on demand. Their solution is to penalize the saver who needs his money by levying a heavy surrender charge against the cash value being withdrawn. If the demands for cash assume the proportions of a "run," they want to seize the opportunity to *improve* their "surplus position." In other words, they want to make money on someone else's misfortune.

The *Transactions of the Actuarial Society of America* discloses the views of yet another actuary, H. Gordon Hurd, who wrote:

> Have we not with nearsighted regard for our investment portfolios assumed contractual obligations calling for a liquidity from 75% to 90%? Have we not sold the agent and the public on cash values?
>
> There is, I take it, unanimity of opinion that the primary function of life insurance is to pay death claims, matured endowments and annuities, and that the granting of loans and cash surrender values is secondary. It follows that the secondary function should not be permitted to impair the primary function. Of course, the radical cure is surgery. Eliminate cash and loan values. I am not prepared to say that this would not be the ideal solution.

Surrender Penalties

Between 1929 and 1936, more than $120 billion worth of life insurance was terminated by lapse or surrender, a huge total by the standards of that day. These were depression years and policy terminations were tragic occurrences in an untold number of instances. In every single case, the termination represented substantial loss to the policyholder. It was no such tragic loss to the insurance companies, though. They operated differently.

Suppose a savings banker said to you, "You are credited with $1000 on your pass book, and you have that much money working at interest. But if you draw it out, we'll penalize you 10% and give you back only $900 of your $1000 on deposit." Would you do business with him?

Against the cash values of those unfortunate Americans who needed their money between 1929 and 1936, the life insurance companies levied a surrender charge of approximately *three-quarters of a billion dollars.*

Actuary Moir looked back on this pound of flesh and insisted that it was not enough. He called for surrender charges "much larger than we now impose." A ghoulish sidelight on the "living benefits" of life insurance, is it not?

Another actuary, Herman C. Kattell, advocated in the *Transactions of the Actuarial Society of America* that cash values be payable in monthly installments over a three-year period because "the companies might need to be relieved of a cash drain for a considerable period of time." These people rush in to offer a banking service—and then they wriggle and squirm when they are asked to make good on their banking obligations. Once they have your money in their possession, they are outraged if you wistfully ask for it back.

Joseph B. MacLean, former vice-president and actuary of Mutual Life of New York and one of the acknowledged authorities in the field, in his book *Life Insurance,*[2] writes that the moratorium

> . . . was purely a protective measure for the benefit of all policyholders which was necessary to prevent the destruction of values by the selfish or foolish behavior of some of them.
>
> Insurance companies are not banks. Their assets are not invested as are the assets of banks, and such a run might have necessitated sales of securities on a scale which would have been disastrous to all concerned and which might have endangered not only the solvency of the life insurance companies but the whole financial structure of the country.

If life insurance companies are not banks, why do they persist in selling "living" insurance? Why do they not restrict themselves to the sale of protection policies as do casualty companies? Why do they send a horde of salesmen across the face of the land to cajole people into buying endowment policies, retirement income policies, and annuities?

[2] *Life Insurance,* 9th edition. Copyright 1962, McGraw-Hill Book Company. Used by permission.

Their activities in the past got them into serious trouble, bringing them and the country to the brink of financial disaster. They have not altered those activities. What will save them next time?

In 1933, the companies made cash payments on policy loans and cash surrendered policies equal to 24.5% of their total assets. Their assets are now about $126.3 billion. Let's assume history repeats itself and they are called upon to again pay out 24.5% of their assets along with the expected death and disability claims, matured policies, commissions and other expenses of doing business, policyholder dividends, etc. The picture might look like this:

Policy loans and surrenders	$30.9 billion
Living and death benefits	9.0 "
Commissions and expenses	10.5 "
	$49.4 "

Deduct the existing $4.4 billion in policy loans and you have $45 billion.

How will the American life insurance industry raise $45 billion in cash in a single year? Here are the industry's recent assets:

U.S. government securities	$ 5.4 billion
Foreign government bonds	0.3 "
State, prov., and local bonds	3.8 "
Railroad bonds	3.1 "
Public utility bonds	14.0 "
Industrial and misc. bonds	22.4 "
Stocks	4.2 "
Mortgages	34.9 "
Real estate	3.1 "
Policy loans	4.4 "
Misc.	4.4 "

How will it raise the $45 billion? That's easy—all it has to do is sell all of its U.S. and foreign government securities, all of its state, provincial, and municipal bonds, and all its railroad, utility, and industrial bonds. Assuming that this prodigious feat could be accomplished, what disruptive effect would it have upon the securities market here and abroad?

Artificial Convention Values

At that secret meeting in February 1933, the insurance industry made another demand upon the insurance commissioners. The market value of their huge securities portfolios had shrunk painfully to the point where a current balance sheet would show that they lacked the reserves legally required to back up their contracts. The market decline was only temporary, they argued, and their securities would recover their values if given time. Meanwhile, they could not put out statements which showed them to be insolvent. They demanded the privilege of listing their security holdings at cost instead of at market. Many of the hundreds of bank failures which had occurred prior to that time could have been avoided if the bankers had been given permission to list assets at cost. Actually, there would have been no justification for such a course—the securities were worth their current depressed market price and no more. True, many of them were destined to recover a good bit of their price loss—but who was to know which ones and how soon? The point is that the insurance companies were no more entitled to falsify their records than the banks were. Certainly the publication of financial statements purporting to disclose the true current financial position of the company based upon valuations which are not the current market price of the securities can only be classified as fraud. It was a case of the end justifying the means. The insurance industry was forced by its banking operations into a position where it had to lie and cheat to save itself.

Joseph B. MacLean, the insurance authority, wrote in his book:[3]

> Surplus was substantially reduced by the reduction in value of non-amortizable securities in spite of the use in the annual financial statements of artificial convention values greater than the current market values.

Each year, a committee of the insurance commissioners of the states publishes a list of securities owned by insurance companies with an "official" price at which the companies

[3] *Ibid.* Used by permission of McGraw-Hill Book Company.

shall carry the securities on their books. These are known as "convention values." Above, MacLean confirms that in 1933 "artificial" convention values "greater than the current market values" were used. In this instance, "artificial" is a euphemism for "false."

Safety Claims

In the face of this incredible record of jiggery-pokery with the books, the life insurance fraternity has during all the years since maintained that as an investment it enjoys a degree of safety absolutely without parallel. The Life Insurance Agency Management Association, a publicity, sales promotional, and lobbying organization maintained jointly by most of the major companies at the expense of the policyholders, has published a booklet entitled "What You Should Know About Permanent Life Insurance," which includes this gem:

> Emphasis on life insurance as good property continued through the early years of the depression of the 1930's. Many companies featured retirement income sales presentations, and in the late 1920's one launched a great advertising campaign on the need for such income. At the same time, the public's faith in property of all other types was badly shaken. The losses suffered by individuals in the stock market crash were legendary and catastrophic. . . . Real estate values were at an all-time low. All banks were closed for a time and many of them failed.
>
> Life insurance, on the other hand, met the severe test of this period, and passed with flying colors. During the years 1930–32, policyholders actually lost less than one dollar per $1,000 of legal reserves held for them by the companies—less than 1/10th of 1%! Every other savings or investment institution suffered a severe loss of prestige while life insurance stood alone in the minds of the public as the bulwark of safety.

I don't see anything there about the moratorium, do you? Nor anything about the artificial convention values which kept the whole industry from being declared insolvent. And that little bit about the loss to policyholders being only one dollar per $1000 of legal reserves—hardly worth mentioning, eh?

According to *Best's 1940 Insurance Reports*, it came to $200 million! Altogether, 14% of all the companies in the industry went into receivership.[4]

I'm willing to concede that the $200 million lost by policyholders of defunct companies was chicken feed when compared with the $3 billion loss suffered by policyholders who lapsed or surrendered policies *in the year 1933 alone*. A good many of those policies were the same high-premium retirement income policies the LIAMA booklet cackles about and which countless thousands of the faithful turned in during those early depression years for 25 cents on the premium dollar, or less.

Can it be that the men who write these LIAMA booklets actually believe this themselves?

Whenever anybody points to the dreary record of insurance-company failure back in the thirties, insurance men brush the facts aside as ancient history. It can't happen now, they tell us. On the contrary, it *can* happen now, and it *does* happen now. The May 5, 1962, issue of the *National Underwriter* told the story of the "financially troubled" Minnesota National Life, whose affairs have been conducted for the past 16 years by the state insurance commissioner because of the "precarious financial condition of the company."

Describing a salvage program by which Minnesota National would be taken over by Minnesota Mutual, the *National Underwriter* reported:

> Under the proposal, objecting policyholders would have the right to receive one-third of the present cash surrender value of their policies upon cancellation.
>
> Commissioner Magnusson said that the affairs of the company have worsened and if the present setup continues, a situation will arise in which there will be no funds to pay the death claims of a number of policyholders dying last.

[4] President Benjamin L. Holland of Phoenix Mutual, whose company launched that "great advertising campaign" on the need for retirement income policies, wrote me: "The Depression did cause substantial capital losses to the insurance industry." But the LIAMA maintains that life insurance "passed with flying colors."

Back in the Rut

The trouble is that a whole new generation of life insurance men are running the industry now. Many of them have no knowledge of the industry's depression troubles or the Armstrong investigation. I recently visited the industry's headquarters at 488 Madison Avenue, New York City, explained that I was doing some research on the moratorium and asked if I might refer to their library and possibly their files for background information. The executive to whom I spoke, a man in his forties, looked blank when I mentioned the moratorium. He'd never heard of it. If a man whose career work is life insurance research hasn't heard of it, we can hardly expect the run-of-the-mill life company executive to know of it. If they don't even know that it happened, they obviously don't know *why* it happened. If they don't know why it happened, they don't know whether similar conditions exist today and obviously they can't guard against similar disasters.

On the contrary, stung by the drop in the average annual premium with the resultant drop in percentage of profits all along the line, the industry has lately launched a powerful drive to re-establish life insurance as a savings and investment vehicle in the public's mind. Expensive advertising campaigns in newspapers and magazines and on television have extolled the benefits of "living" insurance. Individual companies have published, at policyholders' expense, elaborate brochures urging the purchase of "permanent insurance." Articles have been planted in national magazines, many of them written by professors of insurance subsidized by the industry, which deny the superiority of low-cost term insurance and advocate instead high-premium cash value insurance.

This campaign is doing the public a great disservice. It is luring into high-premium policies the funds of uninformed people who will eventually become disenchanted with the policies they have bought and will give them up. The lapse ratio which President Brundage of the Bankers National Life recently described as "frightening" will be pushed still higher.

Actuary James P. Sullivan predicted, you will recall, that inflation would lead many people to draw upon their life insurance cash and loan values in order to employ the money more productively elsewhere. The 1960 payout of cash sur-

render value suggests that he was right. This development is a factor in the present incredible termination rate. (That it is not the prime factor is indicated by the fact that 70% of those who give up policies do so with no cash return to them. Obviously they are not giving up insurance just to get money to invest.)

The banking-and-investment side of life insurance has now reached an all-time high. The conditions which prevailed in 1933 in the industry may yet prevail again.

What will save the industry this time?

There is only one answer. The life insurance industry must divorce itself from the demand-banking business.

Chapter 7

The Lapse Rate

WILLIAM GYBBONS bought that first policy long ago in London for just one reason—to provide protection. That was and is the only reason, the only justification, for life insurance.

Keeping this in mind, let us now see what life insurance companies are doing to provide protection and how permanent their "permanent protection" really is.

The figures below reflect the industry's operations during calendar 1960, the latest year for which detailed figures are available.[1]

Insurance in Force in 1960
versus
Insurance Lapsed or Surrendered in 1960

On January 1, 1960, $369.3 billion of ordinary and industrial life insurance was in force.

During the year 1960, $30.1 billion of ordinary and industrial life insurance already on the books, equivalent to 8½% of all the life insurance in force, was lapsed or surrendered. (*Lapsed* means that it was terminated without any benefit whatever to the policyholder. *Surrendered* means that he got some money back, usually considerably less than he put into it.)

Policies in Force in 1960
versus
Policies Lapsed or Surrendered in 1960

On January 1, 1960, 200 million ordinary and industrial life insurance policies were in force.

During 1960, 16.7 million ordinary and industrial life insurance policies, equivalent to 8.3% of all the life insurance policies in force, were lapsed or surrendered.

[1] Figures and tables in this chapter compiled from *Spectator Insurance Year Book (1961).*

Insurance Sold in 1960
versus
Insurance Lapsed or Surrendered in 1960

In 1960, more than $63.1 billion of new ordinary and industrial life insurance was sold.

During the same year, $30.2 billion of ordinary and industrial insurance already on the books, equivalent to approximately 50% of the new insurance sold, was lapsed or surrendered.

Policies Sold in 1960
versus
Policies Lapsed or Surrendered in 1960

In 1960, 21 million new ordinary and industrial life insurance policies were sold.

During the same year, 16.7 million ordinary and industrial life insurance policies already on the books, equivalent to 81% of *all* the new policies sold, were lapsed or surrendered.

Are these not startling figures? In 1960, while record sales of *new* life insurance were being rung up, an astonishing proportion of all the life insurance which had been accumulated in force by all the companies in all the years to date was going off the books!

Mind you, we're not talking now about death claims that were paid or policies that matured as endowments, or policies that were interrupted because of disability, or policies that were increased, decreased, or otherwise altered.

We are talking only about the life insurance which Americans voluntarily abandoned in a single year, 1960.

How do you explain this fantastic statistic? Has the need for life insurance lessened? Of course not; it has increased. Did the policyholders just conclude that the policies they had bought were not what they thought they were? Did those people who had purchased life insurance as an investment decide, in these inflationary times, that it wasn't a very good investment? Was the $30.2 billion worth of life insurance which they abandoned poorly sold in the first place? Was it misrepresented?

It seems to me that this record of terminations with its clear reflection of dissatisfaction on the part of policyowners is far more significant than the glowing sales reports.

Let's look at some of the leading companies and compare their 1960 sales of ordinary insurance with their terminations that year.

TABLE 4

Company	*New Insurance Issued* Policies	Amount	*Old Insurance Terminated by Lapse or Surrender* Policies	Amount
Metropolitan	1,873,486	$5,518,142,499	567,533	$1,772,482,557
Prudential	1,338,998	7,908,146,318	709,302	3,412,690,681
Equitable, N.Y.	193,781	1,730,046,455	99,881	659,964,823
Travelers	84,394	876,912,500	51,217	414,864,300
John Hancock	402,551	2,236,293,716	233,203	999,887,391
Aetna	62,925	677,719,720	36,587	314,983,551
N. Y. Life	283,937	2,586,150,986	174,912	998,780,576
Conn. General	95,446	780,946,167	30,536	343,947,434
Lincoln National	122,119	1,388,965,002	71,863	542,243,619
Northwest'n Mut.	74,185	864,619,487	36,110	275,517,135
Occidental, Calif.	89,701	1,344,036,518	44,945	513,961,784
Mass. Mutual	71,139	1,000,187,286	33,696	327,816,435
Mutual of N.Y.	106,276	1,049,608,715	50,415	173,776,878
New England Life	74,552	809,388,386	37,564	275,571,777
Continental Assur.	42,739	426,789,689	23,908	211,217,609
Nat. Life & Acc.	146,421	610,879,970	50,614	220,676,084
Mut. Benefit Life	33,367	530,001,565	19,720	173,776,382
Amer. National	169,932	787,517,981	112,269	456,375,634
Penn. Mutual	66,255	698,971,402	33,349	273,450,681
West. & Southern	145,928	511,707,534	54,969	195,633,553
Conn. Mutual	49,605	589,784,885	20,859	198,646,402
Franklin Life	91,321	940,773,875	66,146	554,620,098
Bankers, Iowa	29,616	271,856,311	15,469	117,163,101
Gen'l Amer. Life	12,801	116,141,800	7,800	48,389,660
Calif.-West. States	29,122	240,366,926	8,679	58,258,114
State Mutual	18,796	207,269,775	12,818	82,820,349
Union Central	14,573	170,979,999	8,967	78,561,444
Republic Nat.	100,883	596,077,849	81,485	308,583,445
Prov. Life & Acc.	24,142	193,201,955	11,949	66,817,321
Pacific Mutual	11,948	117,262,225	10,167	88,616,516
Nat. Life of Vt.	18,768	332,659,210	11,849	117,769,327
Life of Virginia	27,247	173,161,422	22,739	126,408,842
Minnesota Mut.	12,078	160,388,028	10,744	75,122,256
Provident Mut.	21,972	248,545,786	10,696	95,418,347
Phoenix Mutual	19,485	233,360,164	14,581	123,202,278
Northwest'n Nat.	20,618	163,728,310	14,474	81,248,234
Home Life, N.Y.	12,665	177,521,447	4,887	48,614,279
United Benefit	50,434	246,339,071	29,191	125,056,693

TABLE 5

Insurance Terminated by Lapse or Surrender in 1960

Ordinary

Company	*Policies*	*Amount*
Metropolitan	567,553	$1,772,482,557
Prudential	709,302	3,412,690,681
John Hancock	233,203	991,887,393
	1,510,058	$6,177,060,631

Industrial

Company	*Policies*	*Amount*
Metropolitan	854,282	$369,081,399
Prudential	525,529	256,253,937
John Hancock	394,969	192,656,765
	1,774,780	$817,992,101

Totals

Company	*Policies*	*Amount*
Metropolitan	1,421,835	$2,141,563,956
Prudential	1,234,831	3,668,944,618
John Hancock	628,172	1,184,544,158
	3,284,838	$6,995,052,732

Between them, these three companies in a single year lapsed or surrendered more than three and a quarter million individual life insurance policies totaling just under *$7 billion!*

Of the 1465 legal reserve life insurance companies operating in the United States and Canada, only 14 have as much insurance in force as these three companies lapsed or surrendered in a single year.

Most men struggle to keep their life insurance in force through thick and thin. Good years and bad, the insurance premium somehow gets paid. But in 1960, almost every tenth man, woman, and child in America terminated a life insurance policy at a loss.

Let's assume that a few people may be expected to find that they bought the wrong kind of insurance or that the policy was misrepresented to them. In a business with the high-sounding ethics claimed by the life insurance fraternity,

misrepresentation shouldn't occur very often. Collectively, the lapses and surrenders should not be a significant total.

But when in a single year the number of people who abandon their insurance is equal to 80% of the number who buy new policies, when $1 worth of old insurance is given up for every $2 worth of new insurance written, isn't something radically wrong somewhere?

The period we are examining was not an exceptional year, mind you. The record has been bad and it gets worse every year.

Do you get the impression that there is a lot of churning going on, that huge numbers of policies are written, stay on the books long enough for the substantial first-year commission to be paid, and then go off the books, perhaps to be rewritten by the same or another agent?

These insurance-sales records are all very fine, but they are being achieved at what terrible price to the public's pocketbook? To what outrageous extent have they inflated the cost of protection for our families, a commodity so essential to all of us?

Were those 16 million terminating policyholders just irresponsible? Were they devoid of normal concern for the welfare of their dependents? Is it true, as an insurance executive said with a shrug, when I quoted these statistics, that they "just don't give a damn"?

Or is this not the most damning indictment of the high-pressure sales methods which are the hallmark of the institution of life insurance and the policy of nondisclosure which is its occupational disease?

Are not these cold, indisputable facts the refutation of the industry's pretensions to high purpose? Here is the inevitable postscript to all the "Application-a-week" clubs and the perennial contests honoring "good old J. B.," the company president, on his umpteenth anniversary.

Here in a capsule is a clue to the schizophrenic personality of this financial Jekyll and Hyde which unctuously concerns itself with the welfare of our widows and orphans the while it plunders our pocketbooks of billions with obsolete or rigged mortality tables and policy churning.

Bear in mind that the figures I have been giving you are not the totals for the industry's past 50 or 25 years, nor even of the last decade.

This is the record of a single "normal" year.[2]

Just contemplate the astronomical total of commissions which were paid for selling the huge number of policies that went off the books during a single year. Take the figures back 10, 20 years. Then project them into the indefinite future, bearing in mind that they have been growing worse with each passing year. Add it all up and you have a measure of this institution's shocking imposition upon a trusting people.

I have read in countless news stories and insurance publications that in 1960 the insurance companies issued 23.7 million new life insurance policies of all types totaling $63.2 billion. Nowhere did I read that 16.7 million policies totaling $30.2 billion had been lapsed or surrendered. We should have the whole story.

I have written to innumerable officers of individual companies, executives of trade associations, and editors of insurance trade papers inviting an explanation of these figures. Friendy fellows that they are, they invite me to lunch but they will just not answer my questions in writing.

The life insurance industry admits expenses of $43 billion dollars during the past 20 years. It has had other expenses that were not reported.

This is the terrible price America is paying the life insurance industry for the "protection" it buys for its family.

Now, still bearing in mind that the purpose of life insurance is to provide protection, let us next relate these disturbing termination figures to the death claims paid.

Death Claims Paid in 1960 versus Cash Surrender Values Paid in 1960

In 1960, $2.3 billion in death claims was paid on ordinary and industrial life insurance.

During the same period, $8.4 billion in cash surrender

[2] Bear in mind, too, that these figures do not include the 16,721,360 group-coverage certificates totaling just under $35 billion which *also* were lapsed or surrendered in 1960.

Add its group-certificate voluntary terminations to its ordinary and industrial insurance lapses and surrenders and we find that in the single year 1960, one company alone (Metropolitan Life) terminated 6.8 million insurance policies and certificates.

values, equivalent to 370% of the amount of death claims, was paid.

Policies Paid as Death Claims in 1960 versus Policies Lapsed or Surrendered in 1960

In 1960, 1.7 million ordinary and industrial life insurance policies were paid as death claims.

In the same year, 16.7 million such policies were terminated by lapse or surrender.

Well, there it is in black and white. We all know that cash surrender involves losses. Life insurance companies, which exist to pay death claims, actually paid out $3.70 in cash surrender value for every $1 disbursed in death benefits.

Even more shocking, they terminated 9.7 policies by lapse or surrender for every policy on which they paid a death claim. For every person who makes money on his life insurance by dying, nine persons lose money by living. This is the industry which prattles about "living benefits"!

Let's take a look at those 38 leading companies again and see how they look when it comes to paying death claims and terminating policies.

TABLE 6

	Death Claims Paid		*Terminated by Lapse or Surrender*	
Company	*Policies*	*Amount*	*Policies*	*Amount*
Metropolitan	123,803	$265,244,194	567,533	$1,772,482,557
Prudential	112,903	218,791,027	709,302	3,412,690,681
Equitable, N.Y.	28,382	116,889,388	99,881	659,964,823
Travelers	13,418	57,500,600	51,217	414,864,300
John Hancock	27,082	61,022,333	233,203	999,887,391
Aetna	11,094	41,583,496	36,587	314,983,551
New York Life	39,884	140,862,710	174,912	998,780,576
Conn. General	4,119	28,673,666	30,536	343,947,434
Lincoln National	11,431	65,295,436	71,863	542,243,619
Northwestern Mut.	18,012	87,873,091	36,110	275,517,135
Occidental, Calif.	4,114	29,223,068	44,945	513,961,784
Mass. Mutual	9,112	48,585,515	33,696	327,816,435
Mutual of N.Y.	18,485	73,438,293	50,415	173,776,878
New England Life	7,851	43,281,380	37,564	275,571,777
Continental Assur.	3,421	14,087,773	23,908	211,217,609

TABLE 6 (continued)

Company	Death Claims Paid		Terminated by Lapse or Surrender	
	Policies	Amount	Policies	Amount
Nat. Life & Acc.	3,218	$ 6,929,097	50,614	$220,676,084
Mutual Benefit	8,983	42,642,611	19,720	173,776,382
Amer. National	4,375	10,509,391	112,269	456,375,634
Penn Mutual	8,591	38,811,111	33,349	273,450,681
West. & Southern	4,850	8,359,859	54,969	195,633,553
Conn. Mutual	4,786	25,393,894	20,859	198,646,402
Franklin Life	2,373	10,430,473	66,146	554,620,098
Bankers Life, Iowa	4,077	14,231,060	15,469	117,163,101
General American	2,577	7,117,200	7,800	48,389,660
Calif.-West. States	1,448	5,622,053	8,679	58,258,114
State Mutual	3,209	14,807,851	12,818	82,820,349
Union Central	5,462	24,861,174	8,967	78,561,444
Republic Nat.	1,593	5,825,035	81,485	308,583,445
Prov. Life & Acc.	1,146	3,736,372	11,949	66,817,321
Pacific Mutual	3,466	12,512,175	10,167	88,616,516
Nat. Life of Vt.	2,946	15,668,379	11,849	117,769,327
Life of Virginia	2,137	6,116,531	22,739	126,408,842
Minnesota Mut.	1,342	4,382,819	10,744	75,122,256
Provident Mut.	3,123	15,623,425	10,696	95,418,347
Phoenix Mutual	3,156	12,377,907	14,581	123,202,278
Northwestern Nat.	1,861	7,397,431	14,474	81,248,234
Home Life, N.Y.	1,859	9,498,668	4,887	48,614,279
United Benefit	2,863	7,360,550	29,191	125,056,693

You will observe that *not a single one* of these 38 leading companies paid out as much in death claims as went off its books in lapsed or surrendered policies.

Chapter 8

Operating Expenses

NOW, LET'S get to the really interesting part—the operating expenses.[1]

Every business has expenses. Life insurance has to be sold. Indeed, to a greater degree than almost any other necessity, life insurance is sold rather than bought. Of course, the primary purpose of life insurance, we have agreed, is to pay death claims. It was not designed as a scheme to pay commissions—or was it?

In addition to commissions, the institution of life insurance has other expenses—salaries, home-office expenses, advertising, conventions, etc. There is no escaping these; they are a necessary part of every business, including the life insurance business. It is not unreasonable, however, for us to inquire about the proportion commissions and other expenses bear to the death claims paid. If, for example, such expenses ran to as high as, say, 10% of the death claims paid, we might perhaps conclude that the cost of providing protection for our dependents was disproportionate to the benefits derived.

Expenses versus Death Claims

Bearing this in mind, let us now examine the commissions paid and other expenses incurred by the industry in relation to the death claims paid:

Death Claims Paid in 1960
versus
Commissions Paid in 1960

In 1960, death claims paid on all policies in force totaled $3.4 billion.

During the same period, commissions paid on all policies totaled $1.6 billion.

[1] Figures and tables compiled from *Spectator Insurance Year Book (1961).*

Death Claims Paid in 1960
versus
Expenses in 1960 (including "Commissions" and "General Expenses")

In 1960, death claims paid on all policies, totaled $3.4 billion.

During the same year commissions and other expenses totaled $3.7 billion.

NOTE: It has been estimated that 55% of all sums paid as death claims consists of the policyholders' own cash value being returned to him. This means that the amount of death claims actually paid out of the companies' pocket in the historical record cited above was only $1.5 billion. The comparison thus becomes:

Actual Death Claims Paid in 1960: $1.5 billion
Commissions Paid in 1960: $1.6 billion
Expenses Paid in 1960 (inc. Commissions): $3.7 billion

Commissions were 100% of actual death claims.
Expenses were 250% of actual death claims.

It would appear that the life insurance industry does not exist to pay death claims so much as to pay commissions and expenses.

Let's go back again to our 38 leading companies and see how they made out individually in this area of expense. Look closely at Table 7 on pages 97 and 98.

Did I hear you say, "Wow!"?

No, you made no mistake. You read it correctly—31 of the 38 companies had expenses exceeding death claims paid.

We've all heard of charity drives where the promoters got more of the money than the charity did. How is this different?

Minnesota Mutual's total expenses were twice its death claims paid. Expenses of Prudential and Franklin Life were more than double death benefits paid. John Hancock's expenses were almost two and a half times death-claim payments, while Life of Virginia's ran three times claims. Provident Life & Accident expenses were more than four times and American National's nearly five times claims.

Western & Southern's expenses were an astonishing seven times death claims.

TABLE 7

Company	Amount Paid as Death Claims	Expenses		
		Commissions	General Exp.	Total
Metropolitan	$265,244,194	$140,902,157	$310,112,653	$451,014,810
Prudential	218,791,027	167,240,131	282,543,041	449,783,172
Equitable, N.Y.	116,889,388	39,364,300	97,224,113	136,588,413
Travelers	57,500,600	13,088,490	25,257,494	38,345,984
John Hancock	61,022,333	56,421,987	83,786,922	140,208,909
Aetna	41,583,496	25,034,486	46,739,589	71,774,075
N.Y. Life	140,862,710	31,320,307	125,386,166	156,706,473
Conn. General	28,673,666	19,470,532	33,306,826	52,777,358
Lincoln National	65,295,436	19,611,007	17,082,639	36,693,646
Northwestern Mutual	87,873,091	28,528,762	13,924,516	42,453,278
Occidental, Calif.	29,223,068	19,577,449	21,312,995	40,890,444
Mass. Mutual	48,585,515	24,517,828	25,670,353	50,188,181
Mutual of N.Y.	73,438,293	16,567,301	38,300,795	54,868,096
New England Life	43,281,380	21,127,496	20,454,678	41,582,174
Continental Assurance	14,087,773	13,173,161	14,451,754	27,624,915
National Life & Accident	6,929,097	30,249,259	29,908,936	60,157,195
Mutual Benefit Life	42,642,611	16,281,475	12,167,733	28,449,208
American National	10,509,391	30,672,867	19,125,006	49,797,873
Penn. Mutual	38,811,111	11,396,787	18,087,076	29,483,863
Western & Southern	8,359,859	27,211,040	29,167,128	56,378,168
Conn. Mutual	25,393,894	15,060,383	13,037,660	28,098,043
Franklin Life	10,430,473	14,902,929	8,603,666	23,506,595

TABLE 7 (continued)

Company	*Amount Paid as Death Claims*	*Expenses*		
		Commissions	*General Exp.*	*Total*
Bankers, Iowa	14,231,060	6,022,100	12,392,068	18,414,168
General American Life	7,117,200	4,368,488	5,855,426	10,223,914
Calif.-Western States	5,622,053	3,620,036	6,980,046	10,600,082
State Mutual	14,807,851	6,041,654	12,196,223	18,237,877
Republic National	5,825,035	3,282,612	5,560,452	8,843,064
Provident Life & Accident	3,736,372	7,276,803	10,484,491	17,761,294
Pacific Mutual	12,512,175	5,468,652	12,382,201	17,850,853
National Life of Vermont	15,668,379	8,894,784	7,498,661	16,392,445
Life of Virginia	6,116,531	9,429,512	9,391,154	18,820,666
Minnesota Mutual	4,382,819	2,905,442	5,717,993	8,622,435
Provident Mutual	15,623,425	5,344,073	10,375,667	15,719,740
Phoenix Mutual	12,377,907	6,231,171	10,822,034	17,053,205
Northwestern National	7,397,431	4,384,074	6,806,505	11,190,579
Home Life of N.Y.	9,498,068	1,338,768	10,728,019	12,066,787
United Benefit	7,360,550	7,238,614	6,168,475	13,407,089
Union Central	24,861,174	4,680,883	9,798,796	14,479,679

National Life & Accident claimed the prize, though. Its expenses were an almost unbelievable nine times death-claim payments!

In 1960, six companies actually paid their agents more in commissions than the companies paid in death claims. These star performers were:

	Commissions Paid	*Death Claims Paid*
National Life & Accident	$30 million	$ 6 million
Western & Southern	27 million	8 million
American National	30 million	10 million
Provident Life & Accident	7 million	3 million
Life of Virginia	9 million	6 million
Franklin Life	14 million	10 million

Now, perhaps you're thinking that these are new young companies that haven't had time to accumulate a lot of tired old policyholders on whom they have to pay claims. Well, here are the dates they were organized:

National Life & Accident	1898
Western & Southern	1888
American National	1905
Provident Life & Accident	1877
Life of Virginia	1871
Franklin Life	1884

If we bear in mind the estimate reported earlier—that 55% of all death claims paid represents the policyholder's own cash value being returned to him—it would appear that *not a single one* of these 38 leading companies paid out of its own pocket claims equal to expenses of doing business, and the great majority of them actually paid out more as commissions to salesmen than they disbursed as actual death-claim benefits to the families of deceased policyholders.

Here's an interesting story from the *National Underwriter* for August 11, 1962, under a headline PROFITS FOR AGENTS SHOULD BE PART OF AN INSURER'S MISSION:

> Profits in the insurance business—especially for agents—got a convincingly stated endorsement this week from J. Edward Day, former Illinois Insurance Director, former Vice-President of Prudential and now Postmaster General

of the United States. "In some segments of the insurance business there seems to be a feeling—however vague and inarticulated—that profit is a dirty word," said Mr. Day. . . . "Many home office executives, if asked to define the mission of their company will mention protection and service—and stop there. If they do this only because they have gotten into the habit of making lofty and high-sounding speeches, then perhaps it is excusable. But if they do it because they feel that the profit motive should not be talked about too openly in polite circles, then I think that they should stop, look and listen. . . ."

Mr Day believes the profit incentive should play a major part in the functioning of insurance companies generally, whether stock or mutual, for in his opinion a part of the mission of an insurance company is to provide an opportunity for its agents to make a profit. . . .

From the figures we have just been examining, it would appear that Mr. Day need feel no concern about the shyness of the life companies when it comes to making profits for salesmen.

Again, in the *National Underwriter* for September 29, 1962, we read more interesting comment on insurance profits:

> The life insurance business has been too concerned with the fallacious idea of distributing life insurance at cost, but this is something that can't be done, President John A. Lloyd of Union Central Life said in the keynote address of the Life Office Management Association meeting here this week.
>
> "There must be profit margins in life insurance, for we cannot live without profit," he declared. "This is a profit system, and whether we be stock or mutual the motive power which keeps us going and growing is profit."

Mr. Lloyd ended by denouncing as "archaic, unrealistic and dangerously restrictive" Section 213 of New York State's insurance laws, which restricts salesmen's first-year commissions to 55% of the first-year premium.

Perhaps though, we are approaching this from the wrong angle. We don't want to be unfair to the insurance companies. Perhaps the expenses would appear reasonable if related to premium income. Let us again look at the 1960 record of the 38 leading companies. (See Table 8.)

TABLE 8

Company	*Premium Income*	*Expenses*			*% of Premium Income which went to Expenses*
		Commissions	*General Exp.*	*Total*	
Metropolitan	$2,429,676,432	$140,902,157	$310,112,653	$451,014,810	19
Prudential	2,237,253,206	167,240,131	282,543,041	449,783,172	21
Equitable, N.Y.	1,105,398,215	39,364,300	97,224,113	136,588,413	13
Travelers	313,625,293	13,088,490	25,257,494	38,345,984	12
John Hancock	712,641,722	56,421,987	83,786,922	140,208,909	20
Aetna	762,861,522	25,034,486	46,739,589	71,774,075	9.5
N. Y. Life	664,603,427	31,320,307	125,386,166	156,706,473	24
Conn. General	341,823,649	19,470,532	33,306,826	52,777,358	16
Lincoln National	223,058,575	19,611,007	17,082,639	36,693,646	16.5
Northwestern Mutual	337,905,639	28,528,762	13,924,516	42,453,278	13
Occidental, Calif.	233,621,312	19,577,449	21,312,995	40,890,444	17
Mass. Mutual	260,609,361	24,517,828	25,670,353	50,188,181	19.5
Mutual of N.Y.	227,663,191	16,567,301	38,300,795	54,868,096	24
New England Life	214,145,138	21,127,496	20,454,678	41,582,174	19.5
Continental Assurance	170,771,978	13,173,161	14,451,754	27,624,915	16
National Life & Accident	157,519,157	30,249,259	29,908,936	60,157,195	32
Mutual Benefit Life	164,853,002	16,281,475	12,167,733	28,449,208	17
American National	124,391,428	30,672,867	19,125,006	49,797,873	40
Penn. Mutual	126,345,168	11,396,787	18,087,076	29,483,863	23
Western & Southern	151,505,179	27,211,040	29,167,128	56,378,168	37
Conn. Mutual	141,693,636	15,060,383	13,037,660	28,098,043	20
Franklin Life	98,811,045	14,902,929	8,603,666	23,506,595	24

TABLE 8 (continued)

Company	*Premium Income*	*Expenses*			*% of Premium Income which went to Expenses*
		Commissions	*General Exp.*	*Total*	
Bankers, Iowa	$135,016,475	$6,022,100	$12,392,068	$18,414,168	13.5
General American Life	74,617,286	4,368,488	5,855,426	10,223,914	14
Calif.-Western States	65,681,943	3,620,036	6,980,046	10,600,082	16
State Mutual	84,998,211	6,041,654	12,196,223	18,237,877	22
Republic National	44,725,199	3,282,612	5,560,452	8,843,064	20
Provident Life & Accident	117,462,822	7,276,803	10,484,491	17,761,294	15
Pacific Mutual	96,507,808	5,468,652	12,382,201	17,850,853	18
National Life of Vermont	88,667,303	8,894,784	7,498,661	16,392,445	20
Life of Virginia	67,391,228	9,429,512	9,391,154	18,820,666	27.5
Minnesota Mutual	41,114,154	2,905,442	5,717,993	8,622,435	21
Provident Mutual	95,418,347	5,344,073	10,375,667	15,719,740	16
Phoenix Mutual	86,737,442	6,231,171	10,822,034	17,053,205	20
Northwestern National	48,300,862	4,384,074	6,806,505	11,190,579	23
Home Life of N.Y.	53,952,214	1,338,768	10,728,019	12,066,787	22
United Benefit	54,588,233	7,238,614	6,168,475	13,407,089	24
Union Central	69,866,459	4,680,883	9,798,796	14,479,679	21

Here is the industry record for 1960 (in billions):

	Expenses			*% of Premium Income which went to Expenses*
Premium Income	*Commissions*	*General Expenses*	*Total*	
$16.7	$1.6	$2.2	$3.7	22.5

This information should be helpful to you in case you thought the insurance company put your premium money away to pay death claims. They do—three fourths of it. The other fourth, a fantastic *$3.75 billion a year,* is siphoned off in expenses.

The trappings of life insurance—the English oak and teakwood, the luminous ceilings, the abstract impressionist paintings, the giant buildings "soaring 42 stories to the sky," the endless all-expenses-paid conventions at luxury resorts thousands of miles from the home office, not to mention officers' salaries and agents' commissions—all this is torn from the financial hides of the policyholders at a rate which would make the great plunderers of history green with envy.

And of course the industry spends quite a bit on advertising. Prudential's 1960 advertising bill was $3.8 million. It spent more on the Rock of Gibralter than the British did that year. Two other typical examples: Allstate Mutual, way down the list in 54th place in insurance in force, spent $3 million; State Farm Mutual, in 53rd place, spent $1 million.

Defending the industry's advertising bill in 1962—a preliminary survey showed that 116 companies alone out of the 1465 in the business spent more than $50 million, or enough to pay fifty thousand $1000 death claims—Henry E. Arnsdorf, Prudential's advertising director, was quoted in the *National Underwriter* (September 22, 1962), as telling a Washington meeting of the Life Insurance Advertisers Association:

> We don't think that this is out of line for most American businesses—particularly those which have as heavy a sales cost factor as life insurance.

Adman Arnsdorf has hit upon precisely the point I wish to make—in an industry which claims largely to be "mutual" (that is, nonprofit) the people who pay the freight, the policy-

holders, have absolutely no say in controlling the "heavy sales cost factor" which helps to make life insurance premiums oppressive.

Not only do the companies spend a lot of money advertising insurance; they also spend a fortune advertising their advertising. The ads they run in general-circulation magazines and newspapers are reproduced full-page in a dozen trade journals with a "here's what we're doing to back up our agents" theme.

Where the Rest of the Money Goes

Now, although it isn't supposed to be the business of life insurance companies to pay living benefits, it is only right to take into account money they paid out in addition to death benefits in figuring out the difference between income and outgo. For example, in 1960 they paid out $1.7 billion in cash surrender "benefits." (I've put the word in quotes because that's what they call it, but if I go down and draw $100 out of the savings bank, I don't figure that the bank has paid me any "benefits." I loaned them some money; now I'm taking it back. The bank isn't doing me any favor. The cash value of an insurance policy represents money that the policyholder has lent the insurance company. Where does he get a "benefit" when he asks for it back?)

Then there are matured endowments, annuity benefits, disability benefits, etc. Throw in every conceivable penny the companies paid out in 1960 and it adds up to $11 billion—versus total income of $23 billion. They added $71 million to their reserves. What happened to the rest?

Those are the figures for just one year. This has been going on for many years. Let's total it up for the years 1940–1960 inclusive:

TABLE 9

	Total Income of All Companies	*Total Paid Out in Living and Death Benefits*	*Retained by Companies*
1940	$ 5,658,000,000	$ 2,644,339,000	$ 2,993,661,000
1941	5,855,000,000	2,525,222,000	2,329,778,000
1942	6,029,000,000	2,402,517,000	3,626,483,000
1943	6,442,000,000	2,365,249,000	4,076,751,000
1944	7,011,000,000	2,481,257,000	4,529,743,000
1945	7,674,000,000	2,667,305,000	5,006,695,000

TABLE 9 (continued)

	Total Income of All Companies	*Total Paid Out in Living and Death Benefits*	*Retained by Companies*
1946	$ 8,068,000,000	$ 2,792,024,000	$ 5,275,276,000
1947	9,114,000,000	2,971,201,000	6,142,799,000
1948	9,751,000,000	3,236,914,000	5,514,086,000
1949	10,376,000,000	3,478,364,000	6,897,636,000
1950	11,337,000,000	3,730,665,000	7,606,335,000
1951	12,012,000,000	3,984,835,000	8,027,165,000
1952	13,076,000,000	4,146,978,000	8,929,022,000
1953	14,271,000,000	4,515,190,000	9,755,810,000
1954	15,280,000,000	4,947,127,000	10,332,873,000
1955	16,544,000,000	5,382,742,000	11,161,258,000
1956	17,865,000,000	5,878,235,000	11,986,765,000
1957	19,333,000,000	6,660,700,000	12,672,300,000
1958	20,249,000,000	7,231,500,000	13,017,500,000
1959	21,790,000,000	7,531,400,000	14,258,600,000
1960	23,007,000,000	8,118,500,000	14,888,500,000
	$260,742,000,000	$89,712,964,000	$171,129,032,000

You will observe that in the past two decades the life insurance companies have taken in $171 billion dollars more than they paid out.

But, at the beginning of 1940, they had accumulated assets of	$ 29,243,000,000
Their net retained income over the past 20 years, after paying all living and death benefits, was	$171,129,032,000
Their assets at the end of the period should therefore have been	$200,372,032,000
But they actually had only	119,696,036,000
They were therefore short[2]	$ 80,675,996,000

For every dollar the life insurance industry has paid out in the past 20 years, it has taken in $2.90. Project these figures into the future and you will get an idea of the drain on the pocketbook of the American people.

We look to life insurance for protection, for security for our families. It has provided $89 billion of security in the

[2] Figures compiled from *Life Insurance Fact Book (1961).*

past 20 years—and all it has asked for supplying it was $260 billion.

We can say that we entered into this crazy contract during the past 20 years because we didn't understand it, we didn't know what we were doing. But if during the *next* 20 years we continue to lay the same substantial proportion of our national income upon the sacrificial altar of this financial Moloch, ought we not to have our collective heads examined?

Let's be a little more specific about the figures for the last 20 years, that is, 1940 through 1960.

The industry took in		$260.742 billion
It paid out		
Living benefits	$69.379 billion	
Death benefits	38.076 billion	
Expenses	43.245 billion	
Taxes, fees, licenses	6.899 billion	
Added to reserves	88.784 billion	
Total it accounts for		$246.383 billion
Unaccounted for		$ 14.359 billion
Average amount unaccounted for per year		$683.47 million

The life insurance industry has mislaid $14 billion over the last two decades. An average of more than two thirds of a billion dollars per year has disappeared.

Where did it go?

Chapter 9

Surrender Losses

AND NOW WE come to the last but not the least of this particular batch of statistics.[1]

Lapses and Surrenders in 1960

Of the 16.7 million policies terminated by lapse or surrender in 1960, the holders of 11 million policies—70% of the total—received nothing. (It is not possible even to estimate the total financial loss to these policyholders.)

The holders of the remaining 5.7 million policies received an average of $131 for each $1000 of insurance which had been in force.

It is estimated that the $1.7 billion cash surrender value received, when related to the total premiums theretofore paid, represented a collective loss of more than $1 billion to the withdrawing policyholders.

In the past ten years, more than 50 million ordinary and industrial life insurance policies have been lapsed or surrendered. The total loss to the American people is incalculable.

Insurance men, engaged in a bitter competitive fight with mutual funds for the investment dollars of the public, choose to fight it out on the grounds of safety. Many people, they declaim, have had occasion to sell mutual fund shares for less than they paid for them. Life insurance, with its guaranteed cash values, eliminates the possibility of loss.

Let it be set down here for the record that in *each* of the last 20 years, more money has been lost by people lapsing and surrendering insurance policies than has been lost by all the people who liquidated mutual fund shares at a loss in the entire past 20 years. The most conservative estimate of policyholder loss in life insurance terminations during the past 20 years is $10 billion. That's ten times the amount that was lost through bank failures in this country during the Depression and the ten years which preceded it.

[1] Compiled from *Spectator Insurance Year Book (1961).*

And they talk about "living benefits" and the "safety" of life insurance!

The average individual wants to do three things: provide protection for his family; accumulate an emergency fund; and build retirement security for himself. Most people in this country end up without adequate retirement security. The record shows that 75% of all those over age 65 have no income at all or less than $1000 per year. One reason for such a strange paradox in this richest country in the world is that we waste so much of our income buying protection that we don't have enough left to build any sort of real financial security for ourselves. With all our fine earnings and diligent saving, we end up dependent upon Social Security.

If the life insurance industry would sell pure protection at a fair price, Americans could buy twice the protection they now carry and have enough income dollars left to assure their financial independence and self-respect at retirement age.

As it is, life insurance, with its "package" of living benefits and death benefits, with its insistence that it is the be-all and the end-all of everything financial, with its ghastly drain on our national pocketbook, is making a mockery of the word *security*.

The men who control the selling and administering of life insurance today are prostituting the high principles and humanitarian objectives of a noble idea. There's nothing wrong with life insurance but the people who administer and sell it.

Surrender Penalties

Reserves are set aside from premiums paid into policies. Under our level-premium insurance system, we pay higher premiums than we need to during the earlier years of a policy. This reserve is then drawn upon by the company to help pay the higher costs which apply in the later years. When a policy provides for payment of a sum of cash at maturity, the premium includes a loading for this. The loading is put aside in the reserve along with the advance premiums.

You would think that if you decided to withdraw from this long-term insurance/savings contract at any time, you could reclaim the advance premiums you had paid and the dollars you had given the company to set aside for you. After all, they've had the use of them. They do give some of those dollars back to you—this is the cash value of the policy. The

catch is that the cash value is not equal to the full reserve of advance premiums and savings dollars. During the first 20 policy years a surrender charge is levied. If you withdraw, you don't get all your money back. The company keeps some of it.

Raymond T. Smith, vice-president of A. M. Best & Co., drew attention to this in an address to the Chicago Investment Analysts Society extolling the merits of owning stock in life insurance companies:

> The industry has no inventory or receivable problems. The former consists entirely of cash and highly liquid assets. As for the latter, if premiums or policy loans are not paid in accordance with provisions, the companies have no alternative except to cancel. Usually, at least on a short-term basis, *the companies benefit by this necessity*. [Italics added.]

So, you see, these wholesale cancellations which represent such a terrible loss to the policyholders are a source of profit to the companies. As long as their agents are out writing new replacement policies (perhaps on the very same policyholders) in large enough quantities, the companies can accept the lapse ratio and keep on smiling. Their sorrow at losing you is assuaged by the killing they make in paying you only part of the reserve and pocketing the rest.

In one of its literary effusions, the Life Insurance Agency Management Association boasts of the money the industry made available to policyholders as cash surrender values during the Depression of the early 1930s, claiming that these funds did much to alleviate the economic distress of the period. It did not mention that against the policy reserves which it thus made available it levied a surrender charge of three quarters of a billion dollars. If that huge sum had been permitted to flow into the economy, it would indeed have done something to reduce the financial distress of the times.

Chapter 10

Invasion of Surplus

ALL LIFE insurance is basically one-year renewable term insurance. Since mortality increases with age, the cost of a person's one-year renewable term insurance must increase each year.

If you buy a policy of pure protection to run for ten years, the premium you pay is arrived at by adding the increasing premiums for each of the ten years and dividing by ten. This average premium is the symbol of our system of modern level-premium life insurance. We don't pay the premium applicable to each individual year; we pay the average premium applicable to the whole term over which the policy is to run. Thus, we pay too much during the first half of the policy's life and too little during the second half.

The extra money we pay during the first half must be set aside by the company to be drawn upon in the later years. This extra premium is considered to be the policy's "reserve." If the company is obligated under our policy to pay us a cash endowment of some amount at some date in the future, then there is added to the premium an amount calculated to accumulate to the endowment figure by the agreed future date. These sums, too, must be set aside by the company and they, too, become a part of the policy's reserve.

When we think of a corporation's reserves, we think of its assets. But the reserves of life insurance companies are not assets; they are the sum total of the individual reserves on all the policies outstanding. An insurance company's reserves are a liability, then, not an asset. The insurance company maintains assets in an amount sufficient to meet its reserve obligations. In an insurance company's statement, then, reserves do not appear under "assets"; they appear under "liabilities" as a charge against the assets. The minimum amount of reserve with which a company must charge itself on each individual policy is set by law.

In addition to the assets held to back up its reserve obligations, each company maintains a second fund called surplus.

Sometimes surplus is subdivided into "special surplus" and "unassigned surplus." These all add up to the same thing; they are extra funds over and above those needed to back up the company's reserve obligations. When a new insurance company is formed, certain funds are paid in and considered to be the company's capital. Generally, right at the very outset additional funds are subscribed to create a surplus. After a company is under way, the surplus grows by additions each year from the company's profits.

With a stock insurance company, the profits are not all distributed. Instead, some profits are placed in the company's surplus. This makes the company appear stronger, and actually it is stronger. In the case of a stock company, the shareholders don't worry too much about the fact that all the profits are not passed along to them in the form of dividends. They know that the profits are right there and that their stock in the company is worth that much more because of the increased funds in the company's possession in its surplus. After all, if those profits were paid to them in dividends, the stock holders would have to pay income tax on them. If that money stays in the company and goes on working, they're getting the benefit of it just as surely as if it had been paid to them and they had then invested it. They haven't had to pay an income tax on it, however.

In the case of a mutual company, the story is quite different. When the profit goes into the surplus, it is not the property of the policyholder. Oh, I know, they *claim* that the company is owned by the policyholders, etc., but there is absolutely no way in which a policyholder can lay his hands on a penny of the surplus. The surplus is a matter of public record and, in the case of the shareholder in a stock company, as the public sees the company assets climbing, the shareholder sees the market price of his stock also climbing. Any time he wants to claim his share of the profits, he just sells his stock. The policyholder in the mutual company has nothing to sell. The surplus doesn't add one penny to the cash value of his policy. If he terminates the policy, the company will pay him the policy's reserve (less any applicable surrender charge), but he receives no part of the surplus.

From their combined underwriting and investment operations, the companies derive a profit. We have seen that the shareholder in the stock company doesn't care if the profits are not distributed in the form of dividends on his stock—

if he doesn't get it in dividends, he gets it in increased assets behind the share of stock he holds.

With the policyholder in the mutual company, it's a different story. If he doesn't get it in dividends, he doesn't get it at all. Since the companies are not supposed to be operating for profit, the profits from their operations *should* be distributed to make the cost of insurance that much cheaper. A large part of the profit is not distributed, however, but is added to surplus.

Why? Why is a substantial part of the annual profit put aside in the surplus instead of being paid to the policyholders?

Purpose of the Surplus

The question *What is the purpose of the surplus?* has been put to a number of leading companies. To give you a clear understanding of that purpose, I am reporting to you here the explanation given by each company. Some of the statements were quite lengthy and I have conscientiously endeavored to reduce them to a few pithy sentences without taking them out of context or omitting any qualifying statements. I invite you to examine them carefully and to note how consistently they agree upon the purpose of the surplus:

> The contingency reserve, or surplus, consists of the excess of the Company's assets over its legally required reserves and other obligations. It is retained to provide protection against possible asset fluctuation, adverse mortality fluctuations and other unforeseen contingencies.
>
> Thomas A. Bradshaw, President
> Provident Mutual Life Insurance Co.

> Surplus . . . represents assets held by the company over and above the "legally required reserves" and the other obligations, in order to provide for unforeseen contingencies and to give extra assurance that the company will be enabled to honor its obligations. "Reserves" require actuarial assumptions involving mortality and interest. Although great care is taken in making these assumptions, like all human planning they are subject to unforeseen and unanticipated fluctuations. The "surplus" funds provide an added cushion for such eventualities.

Some of the "surplus" for Metropolitan . . . has been designated as being held for certain contingencies. For example, about $64.5 million is held for Group Life Insurance to cover epidemics and disasters of the Texas City Explosion type. Another $76.5 million has been provided to cover possible loss or fluctuation in the value of our assets, including the bonds, stocks, mortgage loans and real estate which back Metropolitan's liabilities.

Charles G. Dougherty, Vice-President
Metropolitan Life Insurance Co.

Surplus has three distinct purposes. . . .

The first purpose is to insure solvency of the company in the event of losses or depreciation of our assets. . . .

The second purpose is to provide a fund to cover any losses that might arise from premiums proving inadequate as a result of an unexpectedly unfavorable experience. . . .

The third purpose is to stabilize our dividend scale for policyholders so that annual dividend payments can follow a reasonably steady progression instead of fluctuating in accordance with the experience of each separate year. . . .

E. J. Moorhead, Vice-President and Actuary
New England Mutual Life Insurance Co.

The Surplus Reserve is really an emergency fund. It is maintained to provide for unforeseen contingencies, and for fluctuations which might occur, such as the higher death rate among policyholders which would arise from an epidemic or national catastrophe, or unusual fluctuations which could occur in investment values.

Marion A. Watson, Director
Service Bureau Policyowners
Penn Mutual Life Insurance Co.

The "Special Surplus Funds" . . . have been established to strengthen the Company's position in the event of a catastrophe, such as an epidemic, which would cause an extraordinarily heavy death and disability claim burden for the large numbers of persons who are insured under group contracts. Second, the "Special Surplus Funds" include contingency reserves against adverse fluctuations in values of our security investments, particularly with respect to the stock portfolio.

The "Unassigned Surplus" may be considered to be a cushion against adverse fluctuations or long term trends in mortality, interest, or expense rates which could understandably occur under such commitments as arise from insurance contracts under which a guaranteed rate of premium exists. These fluctuations and possible adverse trends, which can be determined and understood only after a passage of time, cannot be fully comprehended in a legal reserve structure as described above and accordingly are provided for in surplus margins.

J. Edwin Matz, Vice-President
John Hancock Mutual Life Insurance Co.

Experience has shown that there may occur from time to time adverse fluctuations in experience, departing from "normal" more severely than provided for by the reasonably conservative reserve assumptions. Thus, during the influenza epidemic of 1918–19, the mortality rates experienced for a few months were some 50% greater than those experienced immediately before or after the epidemic. During the depth of the depression of the 1930's, disability claim costs were more than double "normal." In this same depression, there were panic market conditions under which the liquidating value of some assets, if they could be liquidated at all, were temporarily far below "normal," although it eventually proved possible to hold on to such investments until they could be restored to good standing, or disposed of at a price that represented no loss of principal. . . . Sums over and above regular policy reserves must be held to enable the company to meet such adverse fluctuations if they recur. This is the basic purpose of the approximately $1 billion held by the Prudential at the end of 1960.

Bert A. Winter, Second Vice-President
and Associate Actuary
Prudential Insurance Company

We must be prepared for favorable and unfavorable changes in the level of mortality and for unforeseen investment difficulties or losses. Hence, while we may refund to policyholders as dividends any portion of the margins in a year's operation that we may regard as divisible surplus, we also exercise discreet business judgment on how much

of a cushion we may need in relation to our total liabilities and the adverse experience we could have and prepare for such eventualities with a surplus.

Harry W. Jones, Senior Vice-President
Mutual Benefit Life Insurance Co.

A company may accumulate additional funds, traditionally called "surplus." The balance of our surplus (after dividends) is either allocated to special purpose funds, or simply retained, as you and I might retain a savings account, for unforeseen contingencies. . . .

With the safety and security of our policyholders in mind, we maintain a reasonable portion of our surplus to take care of possible market fluctuations. The basic reason for a company's surplus account is prudence. While all surplus does belong to the policyholders, it would be imprudent, as well as illegal, to pay it all out in dividends each year.

Since a life insurance company is making guarantees that project years into the future, it is only fiscal good judgment to maintain a cushion to meet unforeseen happenings.

Charles J. Zimmerman, President
Connecticut Mutual Life Insurance Co.

Surplus is the margin that we are holding over and above our Reserve obligations, to enable us to meet the unusual circumstances that may and do arise. The Company may have an unusually heavy experience in death losses one year or another. Conceivably, we could suffer in the market value of some of our securities as between one year and another. If this should happen in a period like 1929–30–31, it could be a serious problem if we did not have surplus to carry us through. So it is the standard practice in the life insurance business to carry, in addition to our legal obligations or our reserves, a reasonable margin of safety in the form of an unassigned surplus.

Harold J. Cummings, President
Minnesota Mutual Life Insurance

The purpose of our surplus funds is to provide a margin for unforseen contingencies so that the Company can carry out its guarantees and obligations even though there is

some unexpected change in our future experience. This could involve a future decrease in interest rates, or an increase in expense rates because of inflation, or an increase in mortality rates because of an epidemic.

Thus, surplus is designed to protect the Company and its policyholders against future contingencies.

Lowell M. Dorn, Vice-President and Actuary
New York Life Insurance Co.

Northwestern's general safety fund . . . may also be called surplus. It is the purpose of the general safety fund to provide protection for the policyholders against unusual mortality fluctuations which might result from severe epidemics (such as were experienced in the influenza epidemic in 1918) and investment losses. . . .

Donald C. Slichter, President
Northwestern Mutual Life Insurance Co.

Our surplus merely represents the amount of our assets that are available for unforeseen contingencies. . . . Unexpected losses might occur from such causes as excess mortality arising from epidemics or excess investment losses due to depressed business conditions. . . . Therefore, in order to protect our policyholders against unexpected and unusual losses, life insurance companies generally consider it necessary to carry excess funds in the form of surplus and various contingency reserves.

Leland J. Kalmbach, President
Massachusetts Mutual Life Insurance Co.

The purpose of the surplus? "Unforeseen contingencies . . . to protect our policyholders . . . epidemics . . . protect against investment losses in market decline like 1929 . . . general safety fund . . . unusual and unexpected losses . . . margin of safety . . . decline in interest rates . . . safety and security of our policyholders in mind . . . prudence . . . good judgment to maintain a cushion . . . meet adverse fluctuations . . . extra assurance . . .," etc. Well, we're pretty clear on the purpose of the surplus, aren't we? We now understand that mutual companies owned by their policyholders do not divide up all of the profits. Some of them are put aside, added to surplus, for our "protection."

Dollar Graveyard

In the case of most companies, the policyholder who dies or whose policy matures is paid off from current investment income. The 1960 figures given below[1] disclose a startling fact about the premium income of some major life insurance companies.

Company	*Paid out this much in death claims and matured endowments*	*But it was able to pay all such claims from investment income, which totaled*	*And thus did not have to use a penny of its premium income, which totaled*
Metropolitan	$680,108,406	$687,876,903	$1,529,484,212
Prudential	541,243,891	602,894,006	1,764,164,053
John Hancock	160,476,163	204,653,932	502,154,302
Equitable	285,880,198	377,112,721	635,080,433
New York Life	195,294,381	238,274,163	553,691,778

It is clear that upon the death of a policyholder, his share of the surplus remains undistributed.

That huge surplus which has been accumulating over the past century is nothing more than the gigantic graveyard of the dollars of generations of Americans who have died and left the "extra safety factor" of their policies tucked away in the vaults of the nation's life insurance companies. And there the dollars could remain until the end of time unless and until an outraged citizenry finally rises up and demands that they be disgorged.

The tidal wave of new companies entering the life insurance business has resulted in increased competition. It has not occurred to the industry to meet the competition by cutting the costs of distribution and administration.

As for the salaries of the top men, the most revealing commentary came from Francis S. Quillan, Prudential vice-president, in a talk to the Society of Life Office Management Association Graduates quoted in the *National Underwriter*:

> A good place to see the signs of down-grading of the executive function would be in salaries. Mr. Quillan said that in his company there has been progress made in re-

[1] Compiled from *Spectator Insurance Year Book (1961).*

ducing costs in every department but that of the management salary account.

As for the fear that automation is causing technological unemployment, Mr. Quillan said that Prudential has stuck to its policy of not replacing a single person with machines.

When they pay $200,000 for a new computer which will do the work of umpteen people, you needn't think that it's going to make your insurance any cheaper. They'll find room for the people somewhere else. After all, it's a mutual company—who cares?

Penalizing the Old Policyholder

The principal method by which the companies have met competition is by upping commissions to an all-time high.

From the first year's premiums, the companies traditionally paid the commission and other costs of putting the business on the books and set up the required reserves. That's old-fashioned, now.

Today, the first-year cost of putting new life insurance on the books is greater than the first-year premium received.

It was always an axiom of the insurance business that each policy or class of policies must be "self-supporting," able to stand on its own feet actuarially. The rule book says that policies or classes of policies should never be called upon to make up losses sustained by other policies or classes of policies.

The American life insurance industry has quietly abandoned this time-honored principle and, like a chain store, has adopted the practice of offering "loss leaders"—policies which (in their earlier years, at least) are sold at a net loss, which loss is charged to other policyholders.

Harold Franklin, president of the Association for Advanced Life Underwriting, made no bones about it in a speech reported in the February 16, 1962, issue of *The Insurance Field*:

> The speculative fever which has dominated our nation's business for the past decade has crept into the life insurance business. Longstanding traditions have been swept aside by the siren promises of increased production.
>
> Carefully husbanded surplus reserves created by years of conservation are financing the free-swinging battle to acquire new policyholders.

Vice-president Raymond T. Smith of Best's, in an address to the Chicago Society of Investment Analysts, explained it:

> Life insurance is essentially a purchase of a long-term nature, with premium payments predicated on a long-term basis. As with any other business, sales cost money. There is also the expense of putting new business on the books. *These two items exceed the first year's premiums, with the excess being financed out of earnings on previously invested assets.* The immediate effect of new sales is to reduce current earnings. [Italics added.]

Life insurance companies are engaging in a wild competitive scramble for business. Costly advertising and promotional campaigns in magazines and newspapers and on radio and television have been a necessary concomitant of this race. Coincidental with it have come pressures to raise agents' commissions. Insurance agents have long railed at Section 213 of the New York insurance laws, which restricts the agent's commission to 55% of the first year's premium. Casting about for a way to circumvent the law, the companies and their agents hit upon "minimum deposit insurance" as the answer. This policy purports to make "permanent cash value insurance" available at a rate equivalent to or less than the cost of term insurance. It is predicated upon the curious hypothesis that if it costs the insurance company $10 to insure you for $1000 for one year under a term insurance policy (which is pure protection), the same company can insure you for the same $1000 for only $9 per year by simply shuffling its own money around.

When the law geared the commission payout to the first-year premium, there was no easy money to be made by selling low-cost term insurance. But if the company could sell a man a high-premium policy with a large first-year cash value—*and loan him that cash value in advance to pay the premium*—it could establish a high-premium base and pay the agent a commission of 55% of that high premium. The company stayed within the law by paying only the prescribed 55% maximum to its agents, but it did so by setting a phony premium which the policyholder did not actually pay. Through tortured machinations involving a loan made in advance on a policy which had not yet been issued, the com-

panies have padded the commission checks of their agents and kept them "loyal."

But the money to compensate the agent and pay the other necessary costs of putting the business on the books has to come from somewhere.

It comes out of the pockets of the old policyholders whose accounts are already on the books.

The amount by which the expense of putting the business on the books exceeds the amount allotted from the premium to cover such expenses is charged to surplus. You'll remember that surplus was accumulated in the interest of greater safety for the policyholders. Now, however, the surplus is being brazenly used to finance the loss leaders which the insurance supermarket is featuring. By charging the huge first-year selling deficits to surplus, the companies are making past and present policyholders pay the high costs of putting new policies on the books this year. It is their hope that future mortality savings plus higher-than-anticipated investment returns will bail them out and that from these sources they will be able to pick up enough extra profit to make up the money which they have in effect borrowed from the older policyholders. To some, a stronger word than *borrowed* may occur.

In *Life Association News* of September 1961, I noted an almost-full-page advertisement for agents to work on commission which read:

> . . . We will pay big commissions for good life business. Our company is medium sized. We have extremely competitive rates, excellent sales material, and an agency department that can give you some help if you need it. *There is plenty of surplus available for expansion.*

There goes the surplus that was built up for the "added protection" of policyholders. There goes the money they didn't pay out in dividends to policyholders because they wanted to make the company "stronger."

In nearly every business, the principal means of meeting competition is by lowering prices. While insurance rates have reflected minor adjustments over the years, in the life insurance business this means of dealing with competition has scarcely been tapped. There is very little real competition between companies on a price basis. The average person doesn't study rates and choose between companies on the simple basis

of who sells the insurance cheapest. Insurance is sold, not bought, and the agent is the all-important factor in the life insurance field. The competition between the companies is therefore for the agents. The companies know that if they have enough good agents working for them, these supersalesmen will put the business on the books.

There is no pressure among companies to reduce rates to meet competition, then. The only pressure is in the area of recruiting and holding agents. Increased commissions have thus become the industry's answer to competition. The company which pays the highest commissions will buy and hold the loyalty of the best salesmen. Far from reducing rates, the companies are under pressure from their agents *not* to reduce them, since the agent's compensation is a percentage of the premium. A 10% cut in premium rates would mean a 10% cut in commission income.

Under the continuing pressure to build bigger sales organizations, the practice of stealing each other's salesmen has become commonplace. You take a proven producer away from someone else by offering him higher commissions. Eventually, someone else comes along and raises the ante, and he's gone. The new companies, fighting to gain a toehold in the business, offer new highs in commissions. Examine the trade papers and you will find companies advertising that they pay 110% to 130% of the first year's premium in commissions. If it's a small new company, it is deliberately going into the red. It's the stockholder's money. How long will they be able to stand the gaff? To what extent has this gamble that the huge long-term profits in life insurance will begin to pay off before they run out of capital, played a part in the difficulties which many small companies have gotten into?

If it's an older mutual company, the excess of expenses over premium income is being charged to the old policyholders, to surplus, the fund which the company claimed it was building up for the greater safety of the policyholders. In defiance of the insurance maxim that each policy must stand on its own feet and not be a charge upon others, millions of new contracts are being put on the books which are "under water" from the start. If they stay on the books long enough, they make up that charge. But we have already examined the incredible termination rate and noted that lapsed and surrendered polices are running at the rate of 80% of new policies sold. While these are obviously a loss to withdrawing policy-

holders, they also represent a shocking loss to the policyholders who remain on the books.

Life insurance policies generally have a cash value of some amount, however small, at the end of the second policy year. If in the most recent year for which detailed figures are available, 70% of terminations were lapses—that is, policies with no surrender value—it is obvious that the great bulk of business going off the books of the insurance companies is business which has been on those books less than two years and which has therefore not yet had time to make up the selling costs. The costs were thus saddled on the old policyholders. Those policies were on the books just about long enough for the agents to collect their big first-year commissions.

It has been established that most policies do not begin to contribute to earnings for five to seven years. It has also been established that the average life of a policy is now seven years. It is clear that an inequitable situation has developed which needs immediate regulatory attention.

If insurance executives are aware of this inequitable situation and permit it to continue, should they not be disqualified from continuing to serve in a fiduciary capacity? If they claim that they didn't know what they were doing, have they not equally disqualified themselves on the grounds of incompetance?

The companies don't want to raise their rates in order to permit increased compensation to their agents. That might put them at a competitive disadvantage. Instead, they choose to gamble that sensational advances in medicine will result in a vastly better mortality experience and that from these mortality savings they will be able to replace the money they "borrowed" from the policyholders.

Interest return definitely runs in cycles. The minimum deposit and other loss-leader policies in most instances involve a projection of future dividends based upon today's level of investment return. If a lower return in the future wipes out the anticipated extra profits from investment, where will the money come from to pay back those sums now being improperly charged to surplus during this orgy of competitive selling?

The *National Underwriter* reported:

> President Rankin W. Furey, addressing the 1961 American Life Convention, observed that in his company [the

Berkshire Life], there are old-timers who point with alarm to the fact that it is spending more than 100% of its loading [the amount allocated to "expenses"] and increasingly so. Referring to the old system of regarding the loading as something that a company must not exceed in its expenses as a dead duck, Mr. Furey said, "We are obviously swinging to a position where we are planning that some of the anticipated margins in the investment and mortality accounts shall be used for operating expenses. This concept reduces the original cost of insurance and makes it easier to buy and sell. I think that it is safe to say that companies using this system are growing faster. It is the foundation upon which quantity discount, cheaper-by-the-dozen and low 'front money' premiums are at least partially based.

"Under the old system we knew exactly what we were dealing with. Under the new system, there are problems, variables. Widely changing margins are introduced and present costs become increasingly difficult to figure and plan."

Mr. Furey pointed out that there have been times, and they may come again, when there were no investment margins above the reserve requirements. The same applies to mortality margins. All this is fine but there are only so many ways we can divide a margin that is in and of itself going to reduce substantially. How much of it should be anticipated for expenses some years ahead?

"I ask that we create a sound actuarial basis for intrusion into and for the total use of these investment and mortality margins.

"I would like statistics and figures to work with more certainty as opposed to relying on intuition, hope or being pushed into any practice by competitive pressure."

Furey should be applauded for his conclusion that every insurance policy sold today should be on a pay-as-you-go basis with no borrowing from the surplus which belongs to yesterday's policyholders in the hope of being able to repay the loan out of excess profits at some date in the future. The alarming thing is that his views were unusual enough to warrant special reportorial attention. In endless hours of reading insurance reports and journals, I have never seen any other similar plea for honest expensing of policies.

The *Life Association News*, reporting the address of Presi-

dent John D. Brundage of the Bankers National Life to the General Agents and Managers Association of New Jersey, said:

> The speaker . . . explained how the first premium doesn't even begin to pay the cost of a new policy, which runs some $135 to $200 for each $100 of actual premium.
>
> In effect the new policy borrows funds from surplus and from previously paid premiums of old policyholders. This "loan," he said, "is not repaid for an average of eight to ten years."
>
> If a policy is lapsed or surrendered before this loan is repaid, the agent thus loses in renewals, the old policyholder loses the unpaid portion of the loan, and the new policyholder loses the coverage as well as the difference between the premiums he paid and the cash value, if any, which he receives upon surrender.
>
> "The termination rate by number of policies is frightening and has caused a real plateau, if not a loss, for many companies. Check your own company and agency for the number of policies in force. If the volume has remained the same, the actual number of policies has probably declined, since the high average policy today tends to offset as many as three or four old policies. If this is true in a specific case," Brundage reasoned, "the lapse ratio may be running as high as 15 or 20 per cent of the number of policies in force."
>
> Most lapses are accounted for by controllable forces, he stated. "The most basic of these is poor prospecting and selling. If the wrong prospect is sold he cannot really be expected to keep up premium payments. Nor can the man who is oversold or sold the wrong plan."

Well, there it is in black and white. For each $100 of premium on a new policy, it costs up to $200 to sell the policy. The teakwood palaces soaring 42 stories into the sky, the conventions in Hawaii, and the inflated commission schedule with which the agent was lured away from another company all have to be paid for. And paid for they are—out of the surplus that was put aside for the greater "protection" of the policyholders or, as Brundage put it, "from previously paid premiums of old policyholders."

If the policy is lapsed within ten years, "the old policyholder loses the unpaid portion of the loan" which was made from his funds. Remember that 70% of the 16.5 *million* policies terminated in 1960 had been in force *less than two years!*

Finally, this insurance company chief executive declares that the number of policies which are being lapsed with resultant loss to old policyholders of the money borrowed from them without their authorization is "frightening."

In 1960, Metropolitan Life lapsed or surrendered 1.4 million policies. The Prudential total was 1.2 million, while John Hancock terminated 0.6 million policies. Between them, these three companies terminated more than three and a quarter million insurance policies totaling nearly $7 billion. What kind of a dent do you suppose *that* made in the "previously paid premiums of old policyholders"?

In 1960, the life insurance companies paid their agents more than *one and a half billion dollars* in commissions. According to Brundage's calculations, that and more came out of the "previously paid premiums of old policyholders."

"Old policyholders." That's us—you and me and the millions of other poor numbered creatures who dutifully write our checks and send them off with unfailing regularity to Mount Olympus. If you are a policyholder of one of these companies, why don't you sit down tonight and write the president of the company a letter and ask him how much those policy terminations cost you?

How the agents who wrote the hundred million policies which have been terminated in the past ten years must bless us as they relax at Greenbrier, Mackinac Island, Boca Raton, the Royal Hawaiian and, all the rest of the happy gathering places so dear to the hearts of insurance men everywhere!

Insurance men are by nature a happy lot. As they pass you on their way to the post office to mail 3276 birthday cards, they call out a hearty, "Helloo-o-o, there!" and make a mental note to drop in and tell you more about "living insurance."

Now you know what they're happy about.

Penalties of Growth

One critic within the industry, Halsey D. Josephson, general agent in New York City for Connecticut Mutual, has bitterly assailed the advertising of what he calls "cheaper-by-

the-dozen" policies—policies which provide for quantity discounts.

Said Josephson:

> Do you think it is morally justifiable to ask the small policyholder to share in the cost of advertising a policy that may be adverse to his interests? There was a time when selling a big policy was advantageous to the small policyholder because he would share in the savings due to the large policy. But do you think that it's right to ask anyone but the buyers of the bargain policies to pay for the promotion of these policies?

Josephson claims that most of the huge advertising budgets of the life insurance companies are wasted, that they would sell just as much insurance without spending all that money. He sees no relationship between sales and advertising budgets.

Pondering the question of whether or not an insurance company is justified in invading the surplus accumulated from the funds of, and for the protection of, old policyholders in order to pay the excessive costs of putting new business on the books, *Probe*, an insurance publication, wondered if a prospective purchaser might not well ask himself:

> "If, to attract *me*, the company is willing to take from *present* policyholders' surplus money it cannot hope to replace through earnings on my business—what may it not be willing to do to *me* later on?"

At the hearings of the Temporary National Economic Committee, Thomas I. Parkinson, then chairman of the board of Equitable, acknowledged that there was a point in the growth of an insurance company where the company should consider whether the advantages of gaining new policyholders were equal to the disadvantages to the existing policyholders caused by the increase in size and other complexities which might arise. Said Parkinson:

> If we did not sell another policy to a non-member [of the Society], and if we did not sell any additional policy to an existing member, the development, assuming that the existing policyholders remain in the institution, would necessarily add to our assets, add to them even faster, I am

told by the actuaries, for the next few years than if we do go on doing business.

In response to a query about the purpose of the surplus, Equitable vice-president and actuary Walter Klem readily acknowledged that one of its purposes was to

> . . . absorb the strain arising from an unusually heavy volume of new business. When the level of new business writings is fairly stable there is no unusual demand on the company's surplus for the purpose of placing new business in force. If, however, a company were in a position in some year to increase rather suddenly its new business writings by (say) 15% or 20%, this could result in a noticeable effect.

E. J. Moorhead, New England Mutual vice-president and actuary quoted earlier, had a very thoughtful and, I think, sensible further comment on the subject of surplus:

> I will begin by admitting that if a mutual life insurance company were to discontinue all new business activities it would be possible to increase its dividend scale to its existing policyholders and thus give them life insurance at a more attractive cost. When we turn to the question whether there is a "premium deficiency" on new business that is being charged to surplus I think that the answer is somewhere in the middle between yes and no. There is some kind of strain on the company's financial structure that arises from acquiring of new business, a strain which puts a top limit on the quantity of such new business that it might be desirable to write having regard for the interests of the existing policyholders.

I believe that it is very significant when the vice-president and actuary of one of the major mutual life insurance companies acknowledges that the best thing that could happen for the policyholders would be for the company to discontinue the issuance of new policies. Freed of the terrible sales expense which is a financial millstone around the neck of the old policyholders, the company could increase its dividend scale to existing policyholders and thus give them life insurance at a more attractive cost.

The avowed objective of a mutual life insurance company is to make protection available to its policyholder-owners at the lowest possible cost. If this be so, then the best way of doing that is to discontinue selling new insurance at their expense.

Moorhead noted that the acquisition of new business puts a strain on the company's financial structure which puts a top limit on the quantity of new business that is desirable. But who is to decide that limit? Certainly not the company itself. Life insurance is a business, a highly competitive business. Its top men are sales executives and its collective field forces constitute the greatest sales organization in the country. Can you imagine any company announcing that it had written all the new business it should properly write this year considering the financial burden such sales put upon the old policyholders, and that accordingly it was notifying its sales force not to send in any more business for the balance of the year?

Does anyone honestly think that such a situation could ever come to pass? If not, someone else must establish the limits of new business which can be accepted without disadvantaging the old policyholders. That someone else should be an independent regulatory authority. The alternative is to make new business pay its own way—not by raising the already-inflated premium rates but by reducing the outrageous costs of promotion and sales.

Earlier in this chapter, we reprinted the formal explanation of the purpose of the surplus as supplied by top-level executives of some of the major companies. It all boiled down to one word, *protection*. There was nothing in any of those explanations about using the surplus to help pay for the current promotional binge on which the industry is embarked. There was nothing about borrowing from surplus to pay agents commissions on new business. No, nothing like that. Just "protection."

I invite you to turn back to those statements, and consider how they square with the facts given in this chapter.

American life insurance companies have more than $7 billion piled up in surplus funds. That money is now being drawn upon to pay salesmen.

Is it not crystal-clear that this whole subject of the invasion of surplus—this violation of funds withheld from the existing policyholders—should undergo the most careful investigation?

Chapter 11

The Mutual Myth

THE MUTUAL LIFE insurance company is an impressive example of equality. Among policyholders, the richest multimillionaire and the humblest workingman have exactly the same voice in the running of the company—none.

Insurance authority Joseph B. MacLean[1] has stated the situation clearly and without equivocation:

> The fact is that in mutual companies, the directors and officers, in effect, control the company.
>
> The officers of mutual companies, although in theory accountable to the policyholders, are not really so.
>
> When an efficient and responsible administration is in power, it is not necessary that the policyholders participate in the management. There would be serious practical objections . . . if it were too easy for policyholders to interfere either individually or collectively in the management.

Is this not an astonishing statement? Who is to decide if the administration is efficient and responsible? The administration? Under the system as MacLean describes it, the administration is the only one who *can* make that decision. As a corollary, MacLean implies that if the administration were not efficient and responsible, the policyholders perhaps *should* be permitted to participate in the management. However, he volunteers no explanation of the circumstances under which a decision could be made that management *was* inefficient and that policyholders should be given the opportunity to protect their interests.

Are these a breed of supermen incapable of error or venality? And if not, what can the policyholders do about it?

The Armstrong investigation report of 1905 said:

[1] *Life Insurance,* 9th edition, McGraw-Hill Book Company, 1962. Used by permission.

> It is of first importance that officers should realize their direct responsibility to those whom they represent and should rely for their continuance in office upon proved efficiency and not upon a practical inability of the policyholders to depose them.

The Armstrong investigators found that the officers of life insurance companies wield great power:

> No tendency in modern financial conditions has created more widespread apprehension than the tendency to vast combinations of capital and assets. But while in the case of the railroads and industrials these vast amounts are mostly fixed in particular productive activities, the larger part of the huge accumulations of life insurance companies consists of assets readily convertible into money and susceptible of application to varied uses. It is this fact which has placed the officers and members of finance committees in positions of conspicuous financial power.

The Senate's Temporary National Economic Committee heard voluminous testimony on the concentration of economic power and concluded:

> Not only is it clear that a comparable condition exists today but it is apparent that the financial power of life insurance executives has grown enormously with the increasing size of the companies.

In most corporate organizations, it is standard practice for stockholders to elect a board of directors. The board of directors then appoints the officers. The officers are accountable to the directors and serve at the pleasure of the board.

Mutual life insurance companies do things in a very different way. When a director dies or retires, the *officers* of the company nominate a new director. When a director's term expires, the *officers* renominate him. The officers are not chosen by the board; the directors are hand-picked by the officers. The director serves at the officers' pleasure.

The TNEC Conclusions

Said the Temporary National Economic Committee: "Life insurance executives and directors constitute a small group that is self-appointing and self-perpetuating."

This conclusion was completely contrary to the testimony of the president of Metropolitan Life, who told the TNEC that the chief advantage of the mutual company was that it gave policyholders the right and practical opportunity to oust directors when those directors were not conducting the company in accordance with the desires of the policyholders.

Let's consider just how valid this testimony was. The TNEC found that in the case of 80 mutual companies studied, 19 of them advised policyholders of the meeting for the election of officers only by notice on the policy or jacket.

Whereas 88% of the stock insurance companies sent special election notices to their stockholders, only 20% of the mutual companies sent such notices to their policyholders.

After examining carefully Metropolitan's method of nominating directors, the committee found that:

> Its effect is to stir up policyholder interest in the election after it is certain that the "administration" ticket will be reelected. No notice is given to the policyholder of his right to initiate an independent nomination. The administration ticket is nominated seven months prior to election and certified to the Superintendent of Insurance according to law. No publicity is given the composition of the slate, however, until much later, after the time for independent nominations is past. At this juncture, one affirmative vote will insure the election of the entire ticket. For reasons which were not made clear, it is precisely at this juncture that the Metropolitan undertakes to interest its policyholders in the election—after the result cannot be changed.

Some companies make no effort to give even the appearance of a bona fide election. Continued the report of the TNEC:

> Three of the four large New York mutuals admittedly do nothing to encourage policyholder voting. The Equitable, New York Life and Mutual Life did not advise their policyholders of their right to initiate independent nominations and in the absence of such nominations, none of these companies mail ballots or proxies to their policyholders or undertake to encourage their participation in the voting. It appeared that the votes cast were largely votes of employees who also happened to be policyholders, and in at least

two recent elections of Mutual directors, for example, all votes with the exception of one or two which could not be identified, were cast by employees of the company.

With such a procedure in vogue, it is small wonder that policyholders become apathetic and managements entrenched.

The TNEC found that in the average election, only 0.55% of the eligible vote was cast, and that minute percentage was cast by and for the management. Where did they get the votes? Read on:

> In the case of the two largest companies, evidence was presented indicating that the agents instructed by the company to solicit policyholder signatures to proxies on occasion signed the proxies without the knowledge or consent of the policyholder.

In a random check of Prudential proxies, it was found that 43% were signed by unauthorized persons. Agents of Metropolitan testified that it was common practice for them to sign the names of policyholders to ballots without the knowledge and authority of the policyholders.

The insurance laws of New York State specifically provide that the vote of a policyholder shall not be voided simply because his policy number is omitted or given incorrectly. The TNEC found that in direct contravention of that law, Metropolitan instructed its counting clerks to void any ballot on which the policy number was not given.

The investigation disclosed that companies are alert to anything resembling independent policyholder action. Speaking of Metropolitan and Prudential, the report noted:

> Both of these companies used their investigative forces to inquire into the personal history of policyholders who requested more detailed information as to their rights to vote.

When a Metropolitan policyholder in Kansas City sent in a post card asking to be advised as to voting requirements and procedure, the company made an investigation to "get a line on him and his interest in the company." Prudential also

"conducted an investigation from which it appeared that representatives of the office of chief inspector for the Prudential had examined exhaustively into the family and background" of a policyholder who made inquiry about voting and requested a list of policyholders.

Actually, it would be impossible to get a list of the policyholders. Metropolitan, it was disclosed, doesn't even keep a list of its industrial policyholders in its home office. They are known there only by number.

Concluded the TNEC:

> Opportunity for policyholders of mutual companies actually to take part in the management of their companies is even less than the foregoing would indicate. The absence of provision for cumulative voting, the occasional use of perpetual or long-term proxies, the staggering of directors' terms, the failure of the companies to bring their management face to face with the policyholders at annual meetings similar to stockholders' meetings, the policyholders' lack of legal authority to gain access to the books and records of the company, or in many states even to obtain a list of their fellow policyholders, are all factors tending to disfranchise the policyholder and to entrench the management. . . .
>
> Perpetual or long-term proxies authorize the representatives of the management to act as his proxy as long as he remains a policyholder or until the authority is specifically revoked.
>
> These proxies are sometimes presented to the policyholder when he joins the company, and indeed one company uses a proxy which requests signatures at the same time that receipt for the first payment is delivered. . . .
>
> Most companies have staggered directors' terms. This places policyholders in a disadvantageous position if they seek to elect a majority of directors since they must prevail not in one election but in two or, more frequently, three, elections in order to place a majority of directors of their own selection on the board. This doubles or triples the effort required and results in great delay, particularly since it puts the existing board on notice of opposition at the time of the first election and thereby enables it better to marshal forces to put down subsequent attempts.
>
> In summary, it may be said that there are many legal

and practical obstacles in the way of policyholders of mutual companies which prevent them from electing directors to the boards of their companies. Not only is the original selection of board members in the hands of the managements rather than the policyholders, but policyholders are found to have no effective recourse against directors whose actions they may deem inimical to their best interests.

The great expense which mutual policyholders must undergo in initiating and perfecting an independent nomination, the apparent unwillingness of managements to educate their policyholders in the advantages and use of their franchise privileges and the many factors which assist entrenched management when it deals with the widely distributed and unorganized interest of the policyholder have but one possible tendency, namely, to foster irresponsibility in the management.

It is a serious question whether a system under which the accumulation of large amounts of policyholder savings are administered by a self-perpetuating group of individuals who have no direct responsibility to the policyholders and whose activities are not even subject to threat of a possible policyholder review, should be permitted to continue.

True, it is the directors who have the ultimate obligation for management, and they are in the eyes of the law trustees charged with a duty to carry out the affairs of their companies in the interests of the policyholders. When it is said that the directors of mutual companies are acting in the interest of the policyholders, however, it should be noted that they are not selected by the policyholders, elected in fact by the policyholders or subject to immediate removal by the policyholders in the event their actions are considered inimical to the policyholders' best interests. There are admittedly great practical difficulties which must be overcome before any true enfranchisement of the policyholders can take place, but until substantial steps are taken in this direction, the management of the mutual life insurance companies will continue on an autocratic basis, and the mutual companies will not have achieved the status of the democratic institutions it was assumed they would be and which they should be if the policyholders' interests are to be served.

The congressional committee noted in passing that the policyholders in stock companies, since they are responsible for the growth of the assets of the company, should have more voice in running the company.

> The fact that stock companies issue participating insurance and are to a large extent reservoirs for the accumulation of policyholder savings suggests the desirability of policyholders' having some right to select and elect directors. With the exception of mutual savings banks, in hardly any other type of business enterprise is such an important contributor excluded from representation on its board.
>
> Reference to a subsequent section of this report demonstrates the ease with which stock companies are bought and sold or traded back and forth between dominant proprietary groups, frequently without regard for the interests of the policyholders concerned. Furthermore, it is undisputed that the directors of stock companies which carry both participating and non-participating insurance on their books are faced each year with the delicate job of apportioning the profits of the enterprise between the shareholders on the one hand and the participating policyholders on the other. In matters of management policy it would appear that the policyholders who contribute the bulk of the assets of the enterprise might well participate.

Many directors have little or no knowledge of what is going on in the company. They are placed on the board as window dressing with the understanding that the company won't bother them too much about attendance at meetings. During six years as a director of Metropolitan Life, Charles M. Schwab attended only three meetings. There are normally 15 to 25 directors' meetings per year. D'Alton C. Coleman was a director for ten years, during which time he attended only nine meetings. William H. Crocker, another director, failed to attend a single meeting in five years.

A classic example of window dressing was the appointment of L. A. Taschereau, Premier of the Province of Quebec, Canada, as a Metropolitan director. He served for 16 years—and never attended a meeting.

The TNEC found that directors fail to function for a variety of reasons.

They live too far away, or are too busy. They are chosen as figureheads and not expected to render any active service. They are inadequately compensated, and are probably not policyholders, hence have no interest at stake. Many fail to recognize the obligations they have assumed in accepting their positions. Large boards dilute the sense of individual responsibility and encourage a director to look to his fellow directors for fulfillment of their duties. Finally, the entrenched status of the board makes its members impervious to policyholder pressure and encourages complacency.

Insurance Directors Directing Banks

Testimony before the committee disclosed that there was a close association between life insurance companies and certain banks, the officers of one being directors of the other. Invariably, these banks were favored with large insurance-company deposits. In more than one case, a bank officer who became a life insurance company director pressured the life company to boost its use of the bank's facilities.

During the long period of low bank-loan rates, many persons submitted their insurance policies as collateral for a bank loan rather than borrow from the insurance company at the much higher insurance-company rates which then prevailed. The TNEC testimony uncovered the fact that it was not uncommon for large New York banks to refuse to make loans on policies issued by an insurance company with which it had interlocking directors and to then actually notify the insurance company so that it could sent its agent around to arrange the policy loan at the higher rate.

The investigators concluded:

> There is danger that as individual companies grow and their directors tend to become more immune from policyholder pressure, they may act in disregard of the policyholders' interest. The all-too-frequent use of their positions by some directors to promote their selfish purposes, especially when coupled with the power of these same directors to perpetuate themselves in office regardless of their efficiency or their concern for the welfare of the policyholders, gives rise to situations where laxness in administration may flourish and breach of trust may pass unheeded. If these tendencies become too marked, there can be no check on

the honesty or prudence of the executive officers and deterioration of management is certain to eventuate.

The committee found that this wasn't all just a theoretical possibility. It was actually happening:

> Flagrant cases of conflict and breach of trust exist. Until these are eliminated by a wider acceptance of the attitude taken toward these problems by the more progressive states and the more enlightened company managements, the funds of many policyholders will remain in jeopardy.

Elsewhere in this book we have noted the marked difference in the operating costs of stock and mutual companies. The TNEC also observed that difference. It found that the average mutual-company president received a salary 58% higher than that of the average stock-company president.

In the light of these facts, how shall we evaluate the testimony of the president of Metropolitan Life, who explained to the committee that the chief advantage of the mutual company was that it gave the policyholders the right and the practical opportunity to oust directors when those directors were not conducting the company in accordance with the desires of the policyholders?

In the modern history of American life insurance there is but one recorded instance of the election of an independent slate of officers in opposition to the administration slate. That happened in a tiny assessment company, scarcely known beyond the borders of its own state.

Other Abuses

There are innumerable instances of nepotism. Ralph Hendershot, long-time New York financial editor, in his book *The Grim Truth about Life Insurance*, offers this amusing observation on the opportunities available to life insurance company officers and directors to place

> . . . a friend or relative in a well-paid and perhaps not too arduous or demanding a job. The nephew of the president's wife, who had to be towed through Princeton on a tutorial hawser, winds up as a vice-president in charge of perforating cancelled contracts. And who is to complain

or carp about this in a nice friendly, self-perpetuating club? Which director will object? He too may have a stupid son or grandson coming along whose employment problem may be so acute that siphoning him into an insurance job may be the only way out!

The TNEC investigation made it crystal-clear that the life insurance industry is flagrantly in violation of the anti-trust laws. Said the committee in its final report:

> It now appears that the principal life insurance companies have for several years undertaken to eliminate rate competition by means of intercompany agreements and "gentlemen's understandings." Efforts in this direction have been highly successful and, as might be expected, the agreements have been extended to bring about uniformity in certain underwriting practices and in certain policy provisions as well.
>
> For nearly 20 years actuaries representing the principal life insurance companies have met at the home offices of the New York Life to discuss annuity rates, policy provisions, underwriting problems, dividends and similar matters. These conferences have resulted in the elimination or reduction of intercompany competition in many important phases of the life insurance business. The conferences take place from two to four times a year in the office of Dr. Arthur Hunter, chief actuary and vice-president of the New York Life. Usually representatives of about 20 of the largest companies attend.
>
> Following a conference, Dr. Hunter, by pre-arrangement, acts as a sort of "clearing house;" representatives not authorized to bind companies at the conference may report back to him the substance of their talks with their superior officers and the nature of the final decision reached by their companies with respect to a proposed line of action. Thereafter, follow-up letters keep every company informed of the action taken by other companies participating in the conference. Successive meetings are sometimes necessary to crystallize opinion. On occasion, special committees have been chosen to explore a problem and report back on the most likely basis upon which a uniform agreement can be reached.
>
> No minutes are kept of the proceedings and at the end

of each year, Dr. Hunter's files relating to any subject upon which discussion has been closed are destroyed. No publicity is given to the deliberations and no representative of any state insurance commission or other governmental authority is present or invited to attend.

What is the power of the life insurance industry that has miraculously kept the inquiring minds of the anti-trust people away from the subject of life insurance in the face of this specific finding of a congressional committee that the industry eliminates rate and other competition by intercompany agreement?

The executives of the electrical industry who went to jail recently for quietly agreeing not to undercut each other in the sale of generators must be concluding that they were in the wrong business.

One reason that the life insurance industry has operated free of regulatory restraints all these years is the enormous amount of the policyholders' money spent on lobbying.

Reported the Armstrong investigators of 1905:

> Nothing disclosed by the investigation deserves more serious attention than the systematic efforts of the large insurance companies to control a large part of the legislation of the State. They have been organized into an offensive and defensive alliance to procure or to prevent the passage of laws affecting not only life insurance, but a great variety of important interests to which, through subsidiary companies or through the connections of their officers, they have become related. Their operations have extended beyond the State and the country has been divided into districts so that each company might perform conveniently its share of the work.

Did outraged public opinion or improved state regulation end this lobbying? It did not. In 1941, the Securities and Exchange Commission, reporting the findings of its investigation conducted on behalf of the TNEC, said:

> A clandestine lobby . . . exists. While present-day practices are not as crude as those scored in the Armstrong committee . . . the life insurance lobby has become more polished and its effectiveness has increased through con-

centration of funds and initiative in the hands of a single unit.

No justification exists for a lobby carried on without adequate disclosure and financed with the funds of policyholders whose interests more properly should be guarded by the free judgments of their elected representatives.

This reference to the policyholders' own money being used to defeat their best interests reminds one of the observation of the late Supreme Court Justice Brandeis, that "the fetters which bind the people are forged from the people's own gold."

Perhaps you are thinking that these are things which happened long ago, that such abuses no longer exist. Well, let's bring the record up to date. In the summer of 1962, a great effort was made in Congress to permit the reopening of National Service Life Insurance, the famous GI insurance of World War II, to veterans who had never arranged for its continuance after the war or who, continuing it, had later permitted it to lapse. The life insurance men of the country opposed it vigorously, offering the ridiculous argument that it would cost the government millions of dollars in taxes they would otherwise be paying on the commissions they would earn by selling commercial life insurance to men who could not buy the GI insurance.

The *National Underwriter* boasted editorially of the massive lobbying campaign which had beaten down the bill:

> The . . . industry's massive mobilization to block the unwarranted reopening of National Service life insurance calls for the kind of cheers reserved for major breakthroughs.
>
> . . . The success in blocking the imminent passage of the . . . bill will be a constant reminder that life insurance people, when sufficiently aroused, can be depended upon to work like demons for the good of the business.
>
> . . . When the National Life Underwriters Association executive committee . . . gave the green light for the mobilization of NALU's manpower, Thomas R. Buchanan, New York Life, Arlington, Va., chairman of the NALU committee on affairs of veterans and servicemen, and Carlyle M. Dunaway, NALU general counsel, swung into action. The results of their telegrams to local associations was a grass-roots educational effort among members of

Congress the like of which has probably never before been witnessed.

The result was that instead of reopening the sale of NSLI to some 16 million veterans, it would reopen it to only about 1.8 million. If the Senate refuses to go along with the House version and there is a stalemate, the result will be that the sale of NSLI will not be reopened at all.

. . . No one can help having new respect for the power of cooperative action by volunteer workers in projects of top importance to the life insurance business.

To the congressmen who voted against reopening GI insurance to veterans, it should be a revelation to learn now that the flood of telegrams urging them to the action they took actually originated in the office of the general counsel of the National Life Underwriters Association. The completely spontaneous outpouring of opposition from constitutents back home was completely phony, actually the work of life insurancemen working, as the *National Underwriter* said, "like demons for the good of the business."

Centuries ago, the Mongols exacted tribute from all within their reach under threat of immediate death. In twentieth-century America, the modern mongols exact tribute from millions with the threat of inevitable death. The brigands of that dim past pointed to the headsman's sword to throw terror into their victims. The modern brigands point to the hearse to achieve the same result. The Mongols threatened to sell the wives and children of their victims into slavery. Today, we pay the tribute lest our families be doomed to the slavery of poverty and want.

Our forebears cried "No taxation without representation!" and dumped the tea into Boston harbor. What a grim joke that we, their descendants, have meekly acquiesced in the financial disfranchisement of a nation of 180 million people.

This is the financial phenomenon of our times.

This is the myth of "mutual life insurance."

Chapter 12

Term Insurance

THERE ARE only two types of life insurance: term insurance (pure protection) and other kinds. There are more than 100 types of policies. They are all either term insurance alone or term insurance in conjunction with a savings account.

You buy term insurance on your house and on your car. You pay the insurance company a price for protecting you for a specific period of time. You don't send the company any extra dollars and say, "Here, put these aside for me and give them back to me after 20 years or when I'm age 65 or 100." No, it's an insurance company, not a savings bank. If you want to have a savings account, you open it in a savings bank. You don't mix up your savings with the insurance you buy on your house and your car. Each serves a different purpose and there is no point in combining them.

Fire insurance companies don't sell savings accounts. Suppose, they did, though, and that you had a fire insurance policy and, in addition, you had for several years been accumulating money in a savings account with the same company. Suppose that just about the time your savings account reaches $2000, you have a fire at your house and the loss comes to $5000. The insurance company sends you a check for $2000 with a note attached identifying it as your savings account, and another check for $3000 with a memorandum stating that this is the insurance money. You'd probably write back a sharp note in which you'd point out that the fire insurance loss was supposed to be covered by $5000 worth of insurance, and this had nothing whatever to do with your savings account.

"What," you would ask, "is the point of my paying the premium for $5000 worth of fire insurance if you're going to use *my* $2000 savings account to help pay the claim? Why, according to the way you figure it, I've been carrying 40% of the risk myself!"

Patiently, the insurance company would write back saying, "We charged you for only $3000 worth of protection. We

figured that we were going to use your savings account to help pay the claim if you had a fire, so we charged you a little less premium."

You study the situation a little, and then you write back saying:

"I've been looking over my fire insurance policy and my savings account passbook, as well. I find that technically you're right; you *are* authorized to use my savings account to help pay any claims under the policy. This was never explained to me, though. The agent told me that I had both a savings account *and* an insurance policy. Actually, I had one or the other. If I have a fire, my savings account disappears, being used to pay the claim. If, on the other hand, I find that I need to use my savings account, the fire insurance protection disappears because the policy will be canceled if I withdraw my savings. There's just one exception—I can borrow back from you at 5% the same dollars I am putting into the savings account and on which you are paying me 2½%.

"How did I ever get into this, anyway? I wanted fire insurance on my house. Why didn't the agent just sell me the protection and let it go at that? I wanted the assurance that if I had a fire and suffered a loss, a fire insurance company would make good that loss. I didn't want them using *my* money to pay the claim. So you were selling me the insurance a little cheaper because of the savings account, eh? And well you might, with me carrying 40% of the risk! Why, at this rate by the time I'd accumulated $4500 in the savings account, you'd be carrying practically no risk—and when I had $5000 in the savings account, you'd be carrying no risk at all! I must have been out of my mind to fall for such a fantastic arrangement.

"I was telling the two fellows who live next door to me about this weird plan of yours. It turned out that they both have policies with you, but without savings accounts. One of them puts the extra dollars in the local savings bank where he gets 4% interest instead of the 2½% you pay. He can go down and take the money out whenever he wishes without paying you any interest or losing his insurance. The other fellow invests the extra dollars. He figures the return is about 6%. They're both far better off than I was with this savings account/insurance combination of yours. If I ever get my hands on the character that sold me this crazy idea, I'll crown him."

About now, you're ready to remind me that the title of this book indicated that it was about life insurance—and ask what this fire insurance fantasy has got to do with your life insurance.

Much, dear reader, much—for this is the story of you and your life insurance.

Two Basic Principles

It is a fundamental principle of insurance that we insure *risks*. "Risk" implies the possibility of loss. If loss is inevitable, there is no risk and insurance is impractical if not impossible. Death is certain to occur, therefore nobody will insure you against death. We can, however, insure against death *within a certain period of time.*

A second fundamental principle of insurance is that we insure only economic, as distinguished from sentimental, values. How much economic value is there wrapped up in your earned income after age 65? None, if you retire. You may have investment income, but this will keep coming after you die. It won't be lost, therefore you need not insure it. If you will earn no more income, there is nothing to insure. Unless it is for some special purpose, then, life insurance should be planned to terminate at age 65.

It is important that you understand and apply these two fundamental principles if you are to sift through the flood of complicated and confusing policy forms offered today.

When you buy life insurance, you are insuring your future income against your dying before you've had time to earn it. The amount of insurance in force should therefore be the difference between what you have accumulated to date in the way of an estate and the total that you hope to accumulate in your lifetime.

In *A Formula for Financial Independence,* William B. Rudd writes:

> Most families have two estates—an "acquired estate" and a "potential estate." The "acquired estate" is represented by the tangible property currently owned, whereas the "potential estate" is represented by the *future* earning power of the breadwinner. Life and disability insurance policies are designed to protect against the loss of the "potential estate" or a reasonable portion thereof, which

would be occasioned by the breadwinner's premature death or disability.

Since the "potential estate" is relatively large in the early years of family life and gradually decreases to a point where it is virtually nil at retirement, it is clear that the most effective type of life insurance is pure protection on a decreasing basis.

Mortality increases with age at an increasing rate. Therefore, the cost of insurance increases with age at an increasing rate. This is true regardless of the company, the kind of policy or when the policy was purchased. For these reasons, commercial life insurance beyond retirement age is highly uneconomical. The solution is an adequate "acquired estate" at these advanced ages and this can be most expeditiously accomplished through a productive investment program begun as early as possible and continued faithfully through all the years until retirement.

Therefore, the second part of a sound financial plan is to build an "acquired estate." This can be done by investing systematically in "fixed obligations" such as government bonds, savings banks, savings and loan associations, corporate or municipal bonds or by investing in equities through real estate, individual securities or mutual funds.

As your accumulated estate grows, it requires less insurance to complete your estate plan in the event of your death. A convenient and economical way to cover that steadily shrinking potential estate is through reducing term insurance which offers maximum protection at the lowest possible cost.

Level or Reducing Term?

We began this chapter by noting that life insurance is either term insurance (pure protection) alone, or term insurance in conjunction with a savings account. When term insurance is sold by itself, it can be either "level" or "reducing." Term insurance runs for an agreed period of time—1 year, 5 years, 10 years, 15 years, or to age 65 or 70. If you own a $10,000 10-year *level* term policy, it provides $10,000 of protection if you die at any time during the 10-year period. Every penny of the $10,000 paid to your beneficiary comes out of the company's pocket. It's all insurance, all protection. There's no savings account involved here.

If you own a $10,000 ten-year *reducing* term policy, the protection starts out at $10,000 and reduces approximately one tenth each year. The premium doesn't reduce, but the company takes into account the fact that it has a reducing liability by selling this kind of term insurance to you at a cheaper rate than would apply if you bought level term.

Term insurance is either *renewable* or *nonrenewable*. A renewable policy is one which may be renewed without evidence of insurability when the period of time it covers has expired. Thus, if you pass an examination and are issued a 10-year renewable term policy, you may keep on renewing that policy without taking another examination until it expires when you reach 65 or 70. A nonrenewable policy just runs out at the end of whatever period it was originally intended to cover. You can apply for a new one but you must submit evidence of insurability. The only advantage of renewability is that you don't have to take another examination; in each case the premium for the new period will be based upon your attained age. In other words, the premium goes up every time you renew it. If you buy 1-year term, the policy must be renewed each year with a slight increase in premium. If you buy 10-year term, the premium will increase noticeably upon renewal. Other things being equal, the longer the period the policy is to run without needing to be renewed, the higher the premium. When you buy 20-year term, the company simply adds up the premiums you would pay on a 1-year term basis for the next 20 years, divides the total by the number of premiums you will pay, and charges you an average premium. During the first 10 years the premium is more than you'd pay for 1-year renewable term. During the second 10-years it is less. The excess you pay in during the first 10-years is just enough to make up the deficit in the second 10. This is the level-premium concept upon which practically all life insurance is based.

Term insurance policies which cover a long period such as 20 years or "to age 65" have a slight cash value. This is in no way a savings account representing extra dollars which you've asked them to put aside for you; it's simply the extra amount of money you have paid for premiums during the first half of the policy's lifetime and which was scheduled to be used to make up the premium deficit during the second half. If you decide to surrender the policy, the company will, or should,

refund the accumulated overcharge which they will not now need. If you terminate the policy just before it was going to expire anyway, there won't be any refund; you will have used up the premium reserve.

Should you buy level or reducing term insurance? Over what period of time should it run? Should it be renewable or nonrenewable?

There are estate planners who advise: Buy 5-year renewable level term and pay an increased premium every five years. That way your insurance premiums are lowest at the start. The idea is to give the insurance company as little money as possible before you die. There is no point in starting out with a higher premium than necessary just so you can pay a little less the last few years.

These financial technicians hold that it is better to buy level term and give some of it up every once in a while, thus making it "reducing term." They point out that if one became uninsurable, the insurance could be frozen at the level of the then-existing coverage, whereas with regular reducing term, the protection keeps on decreasing even though the owner is not able to continue building his "acquired estate" or to qualify for new additional coverage. They note, too, that each time one gives up some of this coverage there is a proportionate reduction in the premium, whereas the premium for reducing term insurance remains constant even though the amount of protection is reducing from year to year.

One factor which must be taken into account is the practice of most companies of considering each renewal of the term policy as if it were a new sale and paying the agent a full first-year commission for handling what is in most instances simply a mail transaction. If you buy term coverage which runs right through to 65, first year commission expenses are charged against your policy only once.

I am inclined to side with the advocates of reducing term insurance because the rate for this type of coverage is well below that for level term with all companies, and one or two companies have recently come out with reducing-term-to-65 policies with new lower rates.

In buying this kind of protection—in buying any kind of life insurance, in fact—one should take into account that an amount of insurance sufficient to provide one's family with a specified standard of living at today's prices will probably not be enough to provide that same standard of living 5 years

from now. The chances are that one's insurance will need to be increased periodically to keep pace with inflation. Therefore, whether you choose level or reducing term insurance, bear in mind that it will need constant reappraisal to determine if it is still adequate.

M. Albert Linton, a former insurance company president and actuary, has written:

> Because of internal savings resulting from combining the protection and the investment elements in one contract, the charge for the term insurance element is lower than the rates on a separate term insurance policy.

This is understandable. Cash value life insurance is part insurance and part savings account or, as Linton calls it, "investment." The cost of setting up the policy is split between the two parts. If you buy just the protection, the policy cost will all be charged to that one part. Term insurance purchased on its own is therefore slightly more costly than when purchased in conjunction with a savings account. In the long run, though, the additional cost is of small significance as an expense factor, and well worth paying.

In summary, then, term insurance is the insurance element of every life insurance policy, so we can dismiss as immaterial all of the arguments for and against term insurance. The arguments against term insurance are really arguments against life insurance itself. The whole seemingly complex problem of life insurance can be resolved into this fundamental question: "Shall I buy term insurance by itself, or shall I buy term insurance in conjunction with a long-term savings plan?"

Chapter 13

Cash Value Life Insurance

So MUCH for the essential facts about term insurance. We now address ourselves to the "other kinds." This is what 99 out of 100 policyholders own. The "other kinds" consist, you will remember, of some combination of reducing term insurance plus a savings account which the insurance companies call the "cash value." When you buy "whole life," "ordinary life," or "straight life"—different names for the same thing—you are buying reducing term insurance to age 100 plus a savings account which matures on that date for an amount equal to the face of the policy.

You are saying to the insurance company, "Here is the premium for insuring me—and here are some extra dollars which I want you to put aside for me until I am 100 years old." The accumulation of extra dollars is the cash value.

You will recall that on that weird fire insurance policy we discussed in the last chapter, the company used your $2000 of savings to help pay the $5000 claim. Well, that's just exactly what the life insurance company does with those extra dollars you give them to put aside for you. If you die, they add just enough insurance to your savings account to make up the face amount of the policy and pay the total to your beneficiary. The savings account/cash value grows over the years by reason of the extra dollars you have added and the addition of about 2½% interest which the company pays on the account. In the last year, the savings account on a $10,000 policy might be $9950 and the actual insurance protection provided by the company only the remaining $50.

The effect of this type of insurance, which the companies call "permanent" insurance, is to transfer the risk gradually from the company's shoulders to yours. All such policies involve *reducing* term insurance—reducing protection for the same premium with each passing year. Since these policies actually provide no permanent protection but instead require you yourself to assume a constantly increasing proportion of the risk, it is an obvious misrepresentation to call them "permanent" insurance.

All cash value insurance policies should be required to contain a table showing, on a year-by-year basis, the amount of the policyholder's accumulated savings account *and* the amount of actual life insurance in force. The owner of such a policy could then determine at a glance just how much life insurance he was getting for his money.

Why should life insurance companies, when they indicate the amount of protection they are providing for an agreed premium, be allowed to include your savings account as part of that "protection"? A savings account is not protection, nor is it insurance. Why should the companies be allowed to claim it as such? If the savings account which you have in your insurance policy is "insurance," then *all* savings accounts are insurance policies and all savings banks are insurance companies. Postal savings, savings and loan accounts, U.S. Savings Bonds—these are *all* insurance policies, if we are to accept the insurance companies' tortured interpretation of what is "protection."

Ownership of Cash Values

A controversy has raged for years over the question of who actually owns the cash value of the policy. The eminent insurance authority we have cited before, Joseph B. MacLean, former vice-president and actuary of Mutual Life of New York, says in his book *Life Insurance*:[1]

> It is very important to note that under the level-premium plan a policy of $1,000 does not give actual insurance of $1,000 (i.e., the company is never "on the risk" for that amount but only for $1,000 less the policyholder's own accumulated excess payments). It is thus evident . . . that the plan is really not pure insurance but rather a combination of a decreasing insurance with an increasing investment, the two amounts being combined mathematically in such a way that in any year their sum is equal to the "face amount" of the policy. Failure to grasp this simple fact has led to a great deal of misunderstanding of the level-premium plan.

[1] 9th ed., McGraw-Hill Book Company, 1962. Used by permission.

Opposed to this so-called co-insurance concept is another school which holds that the company is really selling two contracts, one an insurance contract and the other a savings or investment contract. The exponents of this theory claim that if a man dies and the company is required to pay off on the life insurance contract, it should not be entitled to retain his savings or investment account.

Dublin and Lotka, in their book *The Money Value of a Man*,[2] write: "The reserve with interest is increased regularly *and belongs to the policyholder.*"

On the other hand, John H. Magee, in his book *Life Insurance,* states:

> While the insured may have a right to withdraw his policy value, *he does not in fact own it* as long as he allows his insurance to remain in force. . . . It must be clearly understood . . . that whenever a policyholder withdraws his reserves, he is not withdrawing something that is definitely his, as is the situation when a depositor withdraws money from a bank, but rather he is surrendering a part of an insurance policy.

Blake T. Newton, executive vice-president of the Institute of Life Insurance, gives his version of it:

> Straight life is not a savings plan as such. If the insured needs emergency funds, we contract to make a collateral loan at his call, but this is a collateral loan, not a return to him of his money at an agreed rate of interest. The money he has paid as premiums is not his. Once paid, it belongs to the company to be used by it to meet its contracts. He has no right, title or interest in it beyond what is spelled out in the contract. Nothing is accomplished by encouraging the notion that somehow policyholders retain a string on money they pay as premiums in somewhat the same way that savings depositors have a claim on their savings.
>
> Where we have probably gone wrong is in letting agents for sales purposes over-emphasize and glamorize cash values as if they were some sort of glorified savings account . . . , they lack many of the elements of true savings,

[2] Dublin, Louis I. and Lotka, Alfred J., revised edition, Ronald Press Company, 1946. Used by permission.

including availability. You can use them only by paying interest and only at the cost of reducing the value of another of your assets, your life insurance policy.

It is the glib talk about "savings" which has come back to haunt the insurance companies in the bitter criticism that savings are "confiscated" when you die. Actually, it was never intended or expected that you would have both your cash values and your insurance.

As a matter of fact, there seems to be a bit of doubt about who owns the cash values in an insurance policy. In the early days of insurance it was never supposed that a policyholder owned them. They were part of the assets of the company.

The American Experience Table of Mortality, used in this country for nearly a hundred years, was compiled by the great actuary Sheppard Homans, who later wrote:

> There is but one function for the institution of life insurance and that is protection. There is but one form of contract issued by a legal reserve insurance company that will give the insured a square deal. The companies are introducing a savings feature which while it increases the cost of insurance, does not increase the protection. Therefore, the companies should be compelled to open a double-entry account for each policyholder. Then, in the event of the insured dying before the investment part of his contract became effective, the company would be compelled to return to the beneficiary, in addition to the face of the policy, that amount which he had placed with the company for a purpose which he had failed to live to realize.
>
> The investment part of any life insurance contract has no necessary connection with the insurance part; each might be obtained separately for the same aggregate cost, in one company or in two separate institutions.

In New York, several attempts have been made over the years to legislate a requirement that insurance companies pay the face amount of the policy *plus* the cash value. None has succeeded.

The theory of confiscation has many staunch advocates. David Gilbert and James P. Sullivan in *Your Life Insurance*

and What To Do about It, observe that "the life insurance policy, so long as it is a life insurance contract, is not an investment at all. When, if ever, it becomes an investment, it is no longer life insurance."

The Travelers, in an *Agents Service Manual* which it once published, advised agents thus:

> The agent [of the competing company] will probably try to combat this argument by talking cash values. Do not let the buyer of insurance forget that cash values are only theoretical unless he closes out his contract, that he can avail himself of them only by giving up his insurance.

Alden T. Bunyan, second vice-president and associate actuary of Phoenix Mutual Life, has pointed out to me the difference between a regular savings account and the reserve which the life insurance company sells as a "savings account," in these words:

> This differs from a savings account in that the only way it can be withdrawn is by giving up the right to receive the larger sum at death.

In other words, it is a savings account only if one is willing to sacrifice the insurance protection which is the only real purpose of the policy in the first place.

In a very real sense, the savings element in cash-value insurance represents a loan to the insurance company, a loan which involves substantial forfeiture in the event of early termination, which has a negative result for many years, and at best a 2½% to 3½% long-term yield.

Some years ago, the Carnegie Foundation issued a brochure entitled *Some Misapprehensions Touching Life Insurance,* which said:

> There is no way by which a teacher may have the benefit of his insurance policy, and of his saving accumulation during his long period of active life, except by putting them in separate accounts.

Rabbi Stephen S. Wise, invited to speak to the Detroit Life Underwriters Association, startled them with this frank statement:

I like life insurance—straight. It ought not to be mixed or sugar-coated or bound up with anything else.

Charles Brooks, a consulting actuary and author of *Life Insurance for Professors,* wrote:

In any attempt to devise a system of life insurance, a most important step is to effect a separation of those purposes which can be obtained only through insurance from such purposes as investment and savings for old age.

The Savings Bank Insurance Department of Massachusetts observed that:

Endowment insurance is supposedly a combination of savings and insurance, but in the event of death, you receive only the face amount of the policy. The savings part of the premium has been forfeited.

I would not presume to hand down a verdict in a controversy which has divided the experts for the past fifty years. Perhaps, as Joseph B. MacLean[3] says in his authoritative work:

It does not seem to be of any importance which of the ideas is adopted—both are theoretically correct.

Whichever side is technically correct, the results are the same. The policyholder pays the insurance company a premium each year. It matters not to him whether the company apportions it between savings and protection on a 50–50, 60–40, or 80–20 basis. All he knows is that he is paying x number of dollars and if he dies, the company will pay his family $1000.

He didn't seek out an insurance company and ask the price of a savings account. He went there to buy an insurance policy, one which, if he died, would transfer the burden of his family's financial loss to an insurance company. He had neither the intention nor the funds to purchase a policy under which the company slyly transferred the risk from its shoulders

[3] *Op. cit.* Used by permission of McGraw-Hill Book Company.

to his over the years. He wanted simply an insurance policy, not a savings account or a combination of an insurance policy and a savings account.

Taxes

The company claims that it pays you interest on the savings account/cash value. Many insurance men emphasize that the accumulation of cash value in your policy is tax-free. It is true that the cash value increases yearly by reason of the small guaranteed rate of interest added to it. This interest is not taxed to the policyholder simply because, over-all, the policy represents a loss to him.

To the extent that the increase in the cash value comes from the premiums paid each year by the policyholder, as sums representing advance premiums paid under the level-premium system and other amounts set aside toward the payment of a future endowment are added to the policy reserve, it does not in any sense represent earnings to the policyholder and hence should not be taxable to him.

The Life Insurance Agency Management Association, another of the myriad publicity and lobbying organizations maintained by the industry at policyholder expense, in its book *What You Should Know about Permanent Life Insurance,* acknowledges that, "for most ordinary life policies, little or no taxable gain would arise upon surrender at age 65." In other words, in all the long years of premium payments prior to age 65, your policy would be credited with interest on the cash value but during each and every one of those years the policy would still represent a net loss to you, a bad investment. If you had begun making investments in another area at age 30 and continued to invest for 35 years, and then sold out at a loss, how would you describe it as an investment?

In its book, the LIAMA eulogizes this 35-year financial dud in these words: "There is no substitute for life insurance as good investment property."

Mind you, we're not talking about the results of an investment whose termination happened to coincide with a sharp break in securities prices and thus caused a loss to the unfortunate investor who found it necessary to withdraw at that inopportune time. We are speaking of a contract which, according to the frank admission of this authoritative industry publication, *guarantees* you that you will have a loss on

it after 20, 30, or 40 years of regular, faithful periodic investment.

How shall we regard the industry's description of this dreary product as "good investment property"? And what shall we say of those who write that "there is no substitute for it"? Which shall we question, their intelligence or their honesty?

Robert W. Smith, Jr., assistant general counsel of the Union Mutual Life Insurance Company, in a very scholarly and thoughtful paper read to the Association of Life Insurance Counsel, discussed the tax-free accumulation of interest claims made by insurance salesmen:

> This expression has been troublesome from the start. It expresses the concept that the annual interest increments added to the policy reserves, which are not directly taxed to the policyholder, are in some manner comparable to the interest earned on tax-exempt securities. This concept has been criticized severely on occasion on the ground that the interest earned does not belong to the policyholder, but rather to the company, and that the company pays a tax on the investment increment less the amount set aside for necessary reserves; also on the ground that if the insured surrenders or takes his cash value or endowment proceeds at maturity, he pays an income tax at ordinary rates on the full gain.

If the company pays the tax on the investment increment, such tax payment reduces the money left to be paid out as dividends. In effect, then, the tax payment is passed on to the policyholder, and it is not correct to say that the policyholder pays no tax.

The company pays the tax on any investment profit resulting from the employment of the cash value because *it* is the eventual beneficiary of such funds. It probably feels that it would be adding insult to injury to ask the policyholder openly to pay the tax on profits which eventually accrue to the company.

Under the circumstances, should not insurance salesmen be required to stop creating the mistaken impression in the minds of buyers that they will enjoy some sort of special tax exemption or benefit through a "tax-free inside build-up"?

Saving in Retirement

When you buy a whole life policy, not only do you buy insurance but you also enter into a contract to make an investment every year for the rest of your life. This assumes both desire and capacity on your part to make such an investment. Why should one want to invest regularly until the very day of one's death? For most of us, accumulation of savings is the means to an end, not the end itself. We do not live to save; we save to live. In this enlightened age, each of us should be able to look forward to a period of retirement. It should be a time to read all the books we were too busy to read, to shoot all the ducks that have been flying by all the years we were chained to a desk or a machine—and a time to stop paying insurance premiums.

When earned income stops, we are probably going to have to get along on less. With careful planning in advance, we'll come out all right. It'll take a little budgeting in our retirement years but we can all be warm and comfortable. Most of us won't have any new money to invest, though. We'll need every cent of income to live on.

In such circumstances, is it not ridiculous for the life insurance salesman to commit us to invest regularly every year until we are 100 years old? Does it make sense to enter into an investment contract to run for 35 years after retirement, particularly when the contract has severe penalties for termination before the agreed date?

Recently, a couple came to my office seeking confirmation that the life insurance they had just purchased on their newborn daughter was suitable. The child was six weeks old. The insurance company had issued a policy on which premiums were to be paid for one hundred years. On that basis, a child born prior to the Battle of Gettysburg would have made an investment each and every year since—and would not be finished yet!

Insurance men are curiously inconsistent. They warn you that if you buy term insurance it will stop at age 65 or 70, and they will stress the importance of having protection that continues until you are 75, 85, or 95. Then, in the next breath, they will remind you that when you are 65 and your children are grown and on their own and no longer need protection from loss at your death, you can cash the policy in and

use your accumulated savings/investment for retirement purposes!

Phoenix Mutual vice-president Alden Bunyan wrote:

> A substantial proportion of the holders of straight life policies doubtless use their accumulated values to produce life income for themselves (at guaranteed rates) after their families have grown up and they have retired and their need for life insurance has fallen off.

If the need for life insurance *does* fall off at age 65, what is the point of buying a policy which will run through to age 100? Obviously, the cost of insurance in those later years is extremely high. If you purchase, at age 35, a policy to run through to age 100, under our level-premium system the cost of the insurance through all those years right up to age 100 is taken into account in computing the "average" premium you pay. By including the last 35 years, when insurance premiums are prohibitively high, you saddle yourself with an unnecessarily heavy premium during the years from 35 to 65. If a substantial proportion of policyholders give up the contracts at age 65 because the need for insurance no longer exists, what is the point of their buying such contracts in the first place? Why not simply buy policies which run to age 65, and enjoy the much lower rates such policies offer?

Premium versus Increase in Cash Value

Another argument of insurance men relates the premium you pay to the increase in the cash value. If you begin to have doubts about the wisdom of your purchase of cash value insurance and write to the company asking them to send you whatever papers require your signature in order to obtain the cash surrender value, the agent will be dispatched speedily to talk you out of it. "When you pay the $500 premium now due," he will explain, "your cash value will increase by $250. Therefore it is really only costing you $250 to carry the insurance. Why, that's the same as you'd pay for term—so there's no point in making the change!"

This argument typifies the industry's stubborn refusal to take into account the simple fact that your money can earn something elsewhere. If you have $3000 of cash value in the

policy, it *should* increase, not just because some of your current premium payment is being added to it but also because the company agreed to pay 2½% interest on the cash value.

The argument is largely academic, however. It doesn't matter to you how much the cash value increases—the company is going to use it when you die, anyway. Whenever the agent comes boasting about how much your cash value is increasing each year, you can take it as a clear sign that your savings have grown to an appreciable amount. You'd be well advised to get them out of there. If you don't, they'll be a loss to your estate.

Those last four words are particularly irritating to insurance companies. Some years ago, an independent insurance consultant named Legg analyzed some insurance policies for a client and advised him to take the cash value out and replace the policies with new insurance, telling him that if he didn't do it, and died, the $10,870 cash value "will be a loss to your estate." Mutual Life haled him into court on grounds of misrepresentation. In a historic decision, written by Justice Alfred H. Townley, it was held that:

> [Legg's] statement is literally true. In case of death the insured would receive only the face of the policy [$50,000], and would receive nothing more. . . . By surrendering the existing policies and taking out new straight life policies, the insured would have insurance for the same amount, and at death would receive the face of the policies and have $10,870 in addition thereto, which would not be true if the present policies remained in force.

Stung by the reduction in the average premium from $30 to less than $20 during the past decade (and the consequent reduction in commissions), insurance men have launched a campaign to revive the myth that life insurance is a splendid savings and investment medium. As we have mentioned, millions of dollars of the policyholders' money are being spent to advertise "living insurance." Untold numbers of people are being lured into the cash value trap. Like worker bees, they will labor a lifetime to fill the life insurance comb with honey—and then will die and leave it behind. Just as the bee slaves to accumulate honey to protect himself from starvation later on, the policyholder slaves to accumulate

money to protect himself from want later on. Both are robbed of the protection; someone else usually gets the honey—and the money.

Sales commissions have swelled to a mighty total of over a billion and a half dollars per year, and "living insurance" will push them to another new high next year. Another generation of Americans will die leaving families inadequately protected simply because they wasted the bulk of their precious premium dollars buying savings accounts from an insurance company, savings accounts which they could obtain in a bank or through savings bonds without paying anyone a commission. Those who do make it to retirement will end as earlier Americans have ended, with a pittance to show for a lifetime of sacrificial offerings to the giant Moloch with the hearse tucked underneath its arm. From their meager Social Security income, they'll scrimp to keep up the payments on the insurance policies which run until they are age 100. Humbly thankful for the "protection" being given them *by their own savings accounts,* they will die undisillusioned victims of the greatest humbug of our time—"permanent" life insurance.

The "living insurance" campaign is a concentrated attack upon term insurance. Rufas Fort, vice-president of National Life & Accident, sounds a typical note in a talk to the convention of the National Life Underwriters Association:

> The concept of permanent life insurance must be fostered at every opportunity. The conviction that it should arises from the knowledge that permanent life insurance is to the advantage of the agent, the company, the industry. . . . What have the companies done to foster this most-desired concept? My own company has based qualifications for recognition, leaders' conferences, prizes, etc., on net annualized sales commissions and increase, rather than our old volume basis, which permitted term insurance to weigh too heavily in the final result.

Revealing, isn't it? To keep *you* from buying low-cost protection, to keep its agents from selling you low-cost protection, the company deliberately penalizes the agent who sells it by denying him recognition, prizes, and the privilege of attending the all-expenses-paid conventions at luxury resorts.

Seriously, now, do you expect to get unbiased advice from one of those agents?

The futility of expecting unbiased advice from an insurance company or an insurance man is also illustrated by an editorial in the August 1962 issue of *Best's Insurance News*, which reported:

> Metropolitan has made a conscious effort to encourage permanent insurance rather than term through reports to policyholders and *an adjustment in agency compensation.* [Italics added.]

Unbiased advice? When the world's largest life insurance company penalizes its agents financially for selling you term insurance?

Robert B. Hamor, vice-president and director of agencies of the huge Continental Assurance Company, complained in a speech reported in the September 15, 1961, issue of the *National Underwriter* that the growing practice of replacing "permanent" life insurance with low-cost protection policies could mean that "life insurance will go the way of property insurance, with consequent lower and lower commissions."

Dreadful to contemplate, isn't it?

A Belt in the Face

The *National Underwriter,* apparently under the misapprehension that it is read only by people in the industry and is not seen by the general public, editorialized in the June 1, 1961, issue:

> If only an occasional individual were under the illusion that he can do better than the life companies in investing his money, the situation could perhaps be ignored. But the number is growing alarmingly. Their number is getting to the point where if the present trend continues, the outcries against the life insurance business could have a serious effect upon the industry's prestige. For this reason, we believe the life companies should deliberately belt the public squarely in the face with the facts.

What is your reaction to all this? One insurance bigwig says that the concept of cash value insurance should be fostered

because it is to the advantage of the agent, the company, and the industry. Another points out that if the trend to term insurance continues, commissions will get lower and lower. And an industry publication editorializes that if people continue to wake up to the advantages of term insurance the way they've been doing, it will be necessary to "deliberately belt the public squarely in the face with the facts." By the "facts" it apparently means the old song and dance about the safety of life insurance. Are they going to trot out all the same tired old statistics about the market crash of 1929 and what happened to stocks, etc.? Will the "facts" include anything about the moratorium on payment of cash values or the phony valuation of assets to keep the companies from being revealed as insolvent? Perhaps by "facts" they mean grossly misrepresentative 20-year net cost illustrations, or the old patter about "liquidity" and "savings account" and "just come and see us any time you need any money." They'll lend you money—your money—but they'll charge you twice the interest rate they're paying you for it.

Pitchmen say never give a sucker an even break. Experts at the old shell game say that "anyone dumb enough to fall for this deserves to be taken."

One cannot be an expert at everything, though. We must trust the doctor, the lawyer, even the gent who sticks his head inside our balky television set and comes out covered with gold dust.

We've trusted the insurance men during the past 20 years when they were taking in $260 billion and paying out $89 billion. Now they're talking about giving us a good belt squarely in the face because we're starting to ask questions.

If you think this is a laughing matter, just read thoughtfully this excerpt from an article in *Life Association News* describing the activities of the Institute of Life Insurance, another statistical, sales-promotion, and lobbying agency maintained jointly by all companies at policyholder expense:

> A Minneapolis teen-age student says to his father, "Dad, they taught us in social studies class this week that the head of a family should have at least five times his annual income in insurance. Do *we*?"
>
> A Wichita housewife inquires of her husband, "George, today's speaker at the family financial forum spent a long time talking about how you use permanent and term in-

surance. She said that term insurance should be used only when we could measure the length of the risk, because it might expire on us right when we needed it most. Don't you think we ought to convert our term and stick to ordinary life?"

A San Francisco editor orders his assistant, "Kill that dope story on life insurance profits. Doesn't the guy know that three quarters of the assets are in mutual companies and any savings go to the policyholder?"

How does it happen that teen-agers, housewives, and editors are acquiring a bit of wisdom about this business? They're certainly not sitting up late reading insurance texts. How they and millions like them have life insurance facts at their fingertips is a fascinating story—and every element of the business has worked together to write it.

Life underwriters have always known that the best prospect is an informed prospect: a person who knows the advantages of life insurance and wants to avail himself of them.

And if an underwriter wants to sharpen his sales skill, he usually asks himself "What made my last prospect buy?" Aware of the ideas that he presented, the agent of course has a few answers. But the prospect also has a few others because he knew his state of mind when he met the agent —and it may have been a buying state of mind.

Behind all these selling and buying ideas, however, lies an area called either "motivation" or "understanding." It consists of a whole lifetime of articles read, headlines scanned, TV commercials dimly remembered, lectures heard, billboards noted, courses taken, and conversations exchanged.

Whether he sells or buys life insurance, this is how a person gains knowledge about it. Certain groups in the business—companies and institutions—give the seller (or agent) *his* motivation. But the Institute of Life Insurance, working with the life insurance companies, the National Association of Life Underwriters, and other groups, gives the buyer *his* motivation and understanding.

Let's look at just a few ways in which the Institute does this:

The mail. Every working day of the year the Institute sends through the mail an average of 50,000 pieces of material about life insurance. The material covers many subjects:

the mathematics of life insurance, how life insurance benefits the farmers, the value of permanent life insurance, policies a young couple should buy, dangers in replacing existing policies. This material reaches the hands and minds of prospects and motivates them.

Advertising. The Institute's advertisements make more than a half-billion impressions in the newspapers and magazines every year. The carefully constructed advertisments serve this purpose: They give people a warm feeling about the life insurance they own and a desire to ask their agents about what they might need to own.

Magazine articles. Twenty-one major consumer publications last year carried 57 articles about life insurance. Appearing in magazines with over 100 million circulation, 56 articles discussed the advantages of life insurance. (One of the articles was distinctly unfavorable to life insurance.)

It goes on and on, but that's enough, isn't it? The title of the article is "Are We Getting Through To You?" The question here is: Am *I* getting through to *you*? Do you realize the sinister implications of this revelation of the activities of a giant Big Brother who is watching us wherever we go, moving silently in all the avenues of communication, pointing the way for us to think and to act?

The San Francisco editor who ordered his assistant to kill the story about life insurance profits, the innocent-looking speaker at the family financial forum propagandizing on behalf of life insurance-plus-a-savings account, the teacher in Junior's social studies class—are they just dupes in this monstrous conspiracy, or are they creatures of the insurance industry selling themselves, each in his own way, for a few crumbs from the life insurance premium table?

Fifty-six magazine articles favorable to life insurance—and one lone article unfavorable to the industry. Pure chance? That "professor of insurance" right there in your own state university who wrote a sly article downgrading pure protection and puffing "life insurance as an investment"—which is the greater, his stipend from the university or the thirty pieces of silver he is collecting from the life insurance industry for leading his fellow men like a Judas goat into financial mediocrity?

Consider this *National Underwriter* editorial from the September 2, 1961 issue, which complained bitterly that New

York's acquisition-cost restrictions have kept the companies subject to New York law from "progressing" as other companies have:

> There are doubtless some who feel that if life insurance isn't sold cheaply, it should not be sold at all. We believe that life insurance companies should be permitted to develop all the different levels of their natural markets, just short of the point of pricing the product out of the market. The law of demand and supply is a better measure of how much an insurance company ought to charge for its service in merchandising life insurance than any state.

How can the law of supply and demand operate when the price of the product is fixed by industry agreement?

Replacement

In a speech reported in the *National Underwriter* for August 19, 1961, President Deane C. Davis of National Life of Vermont told two hundred leading agents of the company at an "educational conference" held at the Hawaiian Village Hotel on Waikiki Beach, Hawaii (that's about as far as you can get from the company's home office—if you go much farther, you start getting closer to it) that the company will dismiss agents who are "regularly involved" in replacing old policies, even though such replacement was definitely advantageous to the policyholder. In an earlier talk to the members of the Million Dollar Round Table at Bal Harbour, Florida (reported in the *National Underwriter* for July 1, 1961), Davis said: "Agents will not wish to spend all their time defending their past actions. And those who do may well find themselves without a company connection."

That sounds to me like: Let no agent dare to reveal to a client that a policy bought earlier is a lemon, or to suggest a replacement, under pain of being banished and having his policyholders divided up among the other members of the gang.

The Dallas, Texas, chapter of the National Association of Life Underwriters has taken out a policy with the Travelers insuring against the possibility of successful lawsuits brought by nonmember insurance agents. The Dallas chapter was apparently afraid that agents it tried to penalize for giving un-

biased insurance advice that didn't follow the "line" might sue successfully for damages.

In its *1961 Fact Book*, the Institute made the best of an unhappy fact:

> For every dollar of life insurance premium received during 1960, the life companies provided more protection than ever before. While total life premiums rose 4.4% over 1959, insurance protection in force increased 8.3%.

That must have been a bitter admission. The insurance protection per premium dollar rose in spite of all the pressure for living insurance; Americans have begun to decrease their purchases of high-premium policies and switch to term. If selling tactics advocated by the companies had worked better. the record would have shown a lesser amount of protection provided per premium dollar. The industry is constantly lamenting the drop in average premium and discussing how to alter the trend.

Michael H. Levy, outspoken president of the Standard Security Life Insurance Company, is one insurance executive who has sharply criticized the industry's stand on term insurance. It is worthwhile to quote him here at some length:

> The primary function of life insurance is protection. Not only is it the primary function but it is the fundamental function of life insurance to provide protection—not "living" protection as so many companies have euphemistically attempted to portray the product—but against the risk or hazard of untimely death—making it, in all truth, "death" insurance.
>
> Term insurance is . . . the foundation of all insurance, and "permanent" insurance, whether it be so-called "ordinary," "whole life," "limited payment," "endowment," what-have-you—all of these are secondary. A man should purchase these forms of secondary protection only after he has provided an adequate protection foundation out of inexpensive term insurance.
>
> The industry most sanctimoniously holds itself out as a "public service" profession. Bosh! It is a business—it is no profession . . . not by a long sight. You know it, I know it and so does every other thinking person in the business. . . .

There is only one reason why term insurance is pushed under the rug and permanent insurance is pushed to the fore; that is because on individual sales, per thousand dollars of insurance, the agent makes multiples of the amount of money he generally would make on term sales. And from the companies' point of view, the more dollars that go into the coffers of the various companies, the more money there is available to invest, giving the companies greater assets, greater financial power.

The upsurge in term insurance can be attributed primarily to recognition by the average family that what it really needs is not "life" insurance but "death" protection that is adequate to replace the earnings of the breadwinner and to meet new costs occasioned by the loss of a family member.

I feel that it has been and continues to be wrong for the industry to endeavor to sell people on the idea that they are always better served by investing their dollars in the cash values of permanent forms of insurance than by investing some of these dollars in some type of equity investment.

One wonders how the industry can, with such equanimity, talk out of two sides of its mouth at once. At one moment it speaks in favor of the variable annuity concept . . . while at the same time it is claiming that the fixed-dollar cash value is the best way to save money. I fear that the industry renders itself very vulnerable in so arguing.

Most people carry a lot less death protection than they need, and the piteously small amounts that end up as cash values in their policies serve only an unimportant function if they live, no function whatsoever if they die.

President James H. Windsor of Equitable Life of Iowa, at a company convention reported in the *National Underwriter* for May 6, 1961, said:

Although life insurance has made great strides in recent years, there has been a marked tendency in the mind of the public to single out the protection element. For this, the industry, through advertising, through group insurance and through "volumitis," has been largely to blame.

Note that in the eyes of an insurance man, blame attaches

to the act of letting the public know that they can buy protection a little cheaper.

The American Institute for Economic Research, in its brochure "Life Insurance and Annuities from the Buyer's Point of View," says:

> Remember that the higher premium policies reduce the amount of protection that can be obtained for a given expenditure. Term policies may be used advantageously to meet most insurance needs.
>
> Insurance should be purchased with great care so that the maximum protection may be obtained at minimum cost. Most individuals cannot afford all the insurance that they need for the complete protection of their dependents.
>
> We suggest that 5-year term insurance, renewable or convertible until age 60, can be obtained for most needs, including protection of children prior to completion of their education. At 5-year intervals, well before each renewal date, the policyholder should review the changes in his insurance needs. The term insurance to be renewed can then be reduced if the review indicates that this action is desirable.
>
> The reader is cautioned in making comparisons between the cost of 5-year renewable term and ordinary life insurance against concluding that the former is the more expensive insurance. For example in a typical low-cost company the investment of the difference in gross premium between the two classes of insurance at a conservative 3% return approximates the investment element [20-year cash value] of the ordinary-life contract. As the dollar depreciates further, at least an overall 5% return from investments may be anticipated. At the latter rate of return, the accumulated investment of the difference in premiums amounts to a much greater sum than the cash value of the permanent contract.

A typical insurance man's defense of cash value insurance is offered by Charles C. Robinson, who writes an interesting insurance column for the magazine *Trusts & Estates*. Robinson cites the fact that more than 260 corporations list at least $50,000 of life insurance cash values in their annual statements. Says he:

> This seems to prove that 260 corporations are sufficiently sold on permanent life insurance and its cash value accumulations to buy it in large amounts. This means that they consider it a sound and exceptionally liquid investment for some of their surplus.

What it proves, I think, is that the men who make decisions about the purchase of business life insurance (for which there is an unquestioned need) are just as ignorant of the fundamentals of insurance as any other laymen; that insurance ignorance is practically universal and is shared alike by the mighty and the lowly. The man who sits in the company president's chair usually knows no more about life insurance than does the maintenance man who sweeps up after the president has left for the day.

President Harry Wade put his Standard Life of Indiana into the mutual fund business by organizing a fund affiliate. He defended his action before the American Life Convention in Chicago in October 1962:

> Our connection with the mutual fund field . . . has helped us in our selling the admittedly harder to sell, but greater in value, permanent cash value life insurance—greater value both to the insured, the salesman and the company. I doubt if the insurance industry has any great objections to the achievement of these happy results which are in keeping with the traditional precepts of permanent coverage offered by our business.

Isn't it nice that the insurance industry can sell you a policy which (according to the industry) is good for you and is also good for the salesman and for the company? The salesman understands what he is selling and he *knows* that it is good for him. The company also understands its product and it *knows* that the nice dreamy cash value you've bought is good for it. But, do you understand the policy which produces those "happy results in keeping with the traditional precepts offered by our business"? Do you know what you've bought? Do you *know* that it's good for you? Or, like the rest of your generation, are you walking in financial lockstep, buying the same dreary old policies your father and grandfather bought before you?

President Benjamin N. Woodson of American General

Life, according to a report in the *National Underwriter* (April 22, 1961), told a sales congress of Chicago insurance men that "it is virtually a moral obligation of the agent to sell permanent insurance."

Hopeless, eh? With few exceptions, they claim that this two-headed financial monster which they call "permanent, cash value insurance" is a good investment. What hope is there for improvement in an industry which ignores the warnings of Michael Levy and embraces this philosophy?

E. C. Guillet, an actuary, is quoted in *Your Pocketbook Is Leaking!* as saying:

> We all know that the race track, bingo, poker games and dice games are sheer gambles, but you have a better chance of getting a profitable return out of these gambles than you have of getting a profitable return from the cash values or the savings part of your life insurance policy.

Now, when you and I read that statement of an actuary, a man whose business is designing life insurance policies and who knows how they are constituted, we conclude that cash value life insurance just is not a good investment. But "Woody" Woodson reads it, and tells his agents that they have a moral obligation to sell it!

Said Donald I. Rogers, financial editor of the New York *Herald Tribune*, in his column:

> If you want to save money, the best way to do so is directly—by putting your cash into a bank account or government bonds. Saving in the indirect way, by building up the cash surrender value of an ordinary life policy, does not quite give you the same gain for your money as you get operating strictly on your own.
>
> Ordinary life insurance combines protection and savings. In general, you would do better to separate these through term insurance plus any other plan of savings—buying government bonds, for instance.

The American Society of Chartered Life Underwriters, which supplies many daily newspapers with a question-and-answer column on life insurance, offers this typical bit:

> *Question:* My husband wants to buy more insurance . . .

he wants the most protection for the least money. . . . What do you suggest?

Answer: Over the years, we would expect straight life to give your husband the "most for the least."

At this man's age, the premium for straight life was $38.99 per year per $1000. The premium for level term to age 70 was $24.02. She said flatly that he wanted the most protection for the least money. Did he get it? Was he told about term insurance, or was he directed toward that good old cash value insurance which has pushed company profits into the stratosphere? The result: somewhere, a man probably went out and bought a life insurance policy with an "investment" tie-in. In order to keep his protection in force, he will be forced to make the investment part of the premium, whether he has the money or not, for the next half century. Of course, he won't live to collect his investment at age 100. We know who will get it.

The Real Investment

An investment 22 years ago of $1000 in stock of Standard Beneficial Life is today worth *$22 million.* Not so many years ago, you could have bought 100 shares of Life of Virginia for $10,000. Today, the shares are worth $1 million. There are scores of examples like these of the profits being made in the life insurance industry, profits which in 1961 pushed life stocks, as a group, up 90% in price. Cash value insurance, urged upon us by the insurance industry in a thousand cunning ways, is one big reason.

The propaganda in favor of cash value insurance will be found at all levels. Even taciturn Calvin Coolidge, in retirement a director of New York Life (although he knew nothing about life insurance), was prevailed upon to make a radio speech in which he warned policyholders:

> Do not let anyone persuade you to alter or switch your policies without the best advice of the companies that issued them. Beware of the so-called "twister" and abstractor or agent who offers to save money for you by replacing your policy in another company.

Louis B. Tebbetts, a St. Louis insurance consultant, took offense at this suggestion that anyone who advised a policy-

holder to change to a better or more suitable policy was a rascal. He sought compensation and punitive damages of $100,000 against Coolidge and the New York Life. The case was settled out of court with payment of damages and a letter of apology from Coolidge.

The industry was not deterred. David G. Scott, first vice-president and actuary of Continental Assurance, was quoted in the *National Underwriter* (July 1, 1961), as saying that he has

> [H]opes that the recent trend toward term and away from the permanent forms may have ended. This would be good news to the stock companies because they prefer to issue higher-premium forms such as endowment and 20-pay life in order to use the reserves to build up in these coverages a source of excess interest earnings.

This is the way they talk among themselves, frankly acknowledging that the whole thing is actually just a scheme to fatten their profits. Life insurance has two faces, and the one turned toward you never talks like this. The face I've shown you here can be found only by sifting through trade papers that report the exhortations at company and association conventions to "get out and sell cash values."

The director of the Life Insurance Marketing Institute at Purdue University boiled the whole industry argument against term insurance down into this irreducible number of words: "Term insurance is breaking the financial backs of many agents."

When you hear an agent rhapsodizing about the merits of "permanent" insurance, just remember that commissions are arranged to create the largest incentive on the company's most profitable policies. When he tries to talk you out of term insurance, just remember this typical commission schedule:[4]

	Premium	*Commission*
$1000 of term insurance	$ 8	$ 3
$1000 of whole life insurance	20	11
$1000 of 20-pay life insurance	32	14
$1000 of 20-year endowment insurance	48	16

[4] Compiled by the author from various rate books.

Note that if he sells you 20-year endowment, the agent's commission will be five times the commission he'll earn if he sells you term. You can't blame the agent. In many cases he's honest and sincere. He's just been brainwashed by the home office into thinking that term insurance is bad. Perhaps he thinks that *all* life insurance is good for you—and he figures that while he's at it, he may as well sell you a policy which is good for him. He's in business to earn a living and support his family. In a great many cases, he simply has no idea of what he's doing to you. So don't blame him. Blame yourself for expecting to get unbiased advice from someone whose income is so directly influenced by his recommendation. He may even claim to be expert—but I repeat, to be worthwhile, advice must be both expert *and* unbiased.

Would you like some truly expert advice? Rene A. Wormser, member of the New York Bar, is the dean of American estate planners. For years he has directed the New York University course in professional estate planning for lawyers, accountants, trust officers and others who have an interest in this field. *Wormser's Guide To Estate Planning* is a fine investment for anyone.

Here's a sampling of its wise counsel:[5]

> As a means of saving, life insurance has obvious limitations. It has the virtue of compulsion or coercion—having started to pay premiums there is a pressure to continue. But it is a costly saving method, insofar as it builds up for the insured only the cash value. If you live beyond your expectancy, your family would have been better off if you had invested and compounded your savings instead of buying life insurance. . . . Life insurance is vulnerable to inflation.
>
> An intelligent program would involve setting aside part of one's savings for life insurance and the balance for investment. . . . If a man is willing to take the consequences involved, he can accelerate his investment program somewhat by buying term insurance instead of ordinary life. The rates for term are far lower than for ordinary life. Therefore, he can purchase the same protection at less cost

[5] Copyright © 1958. Prentice-Hall, Inc., Englewood Cliffs, N.J. Used by permission.

through the use of term, leaving himself larger net annual savings for investment. . . . The young man who has confidence in his future may well say to himself:

"If I am able, through the cheaper cost of buying term insurance, to build up an investment reserve for myself and my family more quickly, the cash or loan value of an ordinary life policy becomes of comparatively little interest to me. Moreover, as I get along in life, it will become easier for me later to pay higher premiums on any insurance I may then need—whether by extending present term insurance or converting into ordinary life insurance. In the meantime, I am protecting my family for the present at the cheapest cost. It is difficult to save money, and here is one place I can save some for investment. Finally, in view of the vulnerability of insurance to inflation, I believe I am wise to buy the cheapest form I can."

What a man would be doing in selecting term insurance in place of ordinary life would be splitting off the so-called investment feature of his life insurance. He would be buying life insurance and using any available surplus savings for his own investment program.

To bet on life insurance entirely would prevent the building up of personal security, and the family has no true security unless father has. So, selecting the amount and type of life insurance becomes a matter of balancing. No formula can be prescribed. Many factors come into play: the age, health and working capacity of the wife, the number and ages of children, the security of the young father's own economic position in his business or employment, and so on. Insurance protection and investment protection should be built up simultaneously and in the relative proportions which the complex of individual circumstances dictates.

So, in what does a man invest? One way is to pick only the bluest blue chips and ride with them. Another is to delegate the investment function to other persons better qualified than he. One method of doing this is to buy well-selected "mutual funds." These are in the nature of "open end" investment trusts, companies run by professional investment managers whose sole business is investing in a cross section of enterprise.

Interests in such mutual funds can be purchased bit by bit, perhaps on a monthly or quarterly basis. It would be

just about the same payment method as in the case of buying life insurance, except that there would be nothing like a premium default; what you have paid for is yours.

Some months ago, the Boston Chapter of Chartered Life Underwriters sponsored an all-day estate-planning session in John Hancock Hall. Attorney Wormser was the featured speaker, and he stunned the life insurance men. Here's the story as reported in *The Standard,* a New England insurance weekly:

BORROW ON LIFE INSURANCE, INVEST AGAINST INFLATION.

"More people should borrow the loan value of their life insurance progressively and invest the proceeds in equities as a hedge against inflation," New York Attorney Rene Wormser advised 200 life insurance men, attorneys, certified public accountants and bank trust officers. . . .

Attorney Wormser recommended that people view inflation and life insurance in more realistic terms. He pointed out that his method of borrowing on a life policy and investing the proceeds resulted in the insurance reserve being invested in inflation-protected equities, while only the insurance at risk would be attached to the dollar. In buying new life insurance, he favors term or ordinary life since the lower premium would be less affected by inflationary factors.

What this estate-planning mentor is saying is that if you have already fallen victim to cash value insurance and cannot bring yourself actually to abandon policies you've lived with for years, then at the very least you should withdraw all of the cash that you can as a loan and invest it where it will have a fighting chance against inflation. I wonder if Wormser will ever be invited back after that shocker.

Here are some other apt comments on life insurance as an investment:

"Life insurance is not an investing institution. It can never return to the buyer a profit."

—W. G. Gephart, former dean of the School of Commerce and Finance, Washington University, and author of *Principles of Insurance*

"Insurance is not an efficient way to save except for those who find it difficult to save systematically in any other way."
—Beardsley Ruml, former Chairman of the Board of the Federal Reserve Bank of New York

"Those who have insurance to sell sometimes get over-enthusiastic and promise things which can't be delivered. This is especially true when some life insurance agent attempts to sell life insurance as 'the best investment. . . .'

"For people who have not the self-control to save of their own accord, life insurance is a form of 'investment.' Clients, however, who have the self-control to save of their own accord need not purchase life insurance as an investment. Buy life insurance for protection, the same as you would buy fire insurance or automobile insurance, but think twice before buying it as an investment."
—Roger W. Babson, noted economist

Reported *The Wall Street Journal:*

Life insurance grows less attractive to many as a way to save.

Although policy sales keep increasing, a growing share of the volume is in low-cost term insurance which provides death benefits but no savings for the future. Buyers of term insurance are tempted to put savings into such investments as stocks and mutual fund shares in hopes of obtaining a higher rate of return and greater protection against inflation. . . .

The trend to term has slowed the growth rate of funds which life insurance companies have for investment.

The companies insist that they recommend "permanent" insurance because it is the best kind for the policyholder. Chairman Charles E. Becker of Franklin Life, in a very indiscreet interview that appeared in the December 15, 1959, issue of *Forbes* magazine, let the cat out of the bag. Reported *Forbes:*

In 1958 . . . Franklin earned 18.9% on stockholders' equity, compared to next-best Liberty National's 17.2%. In the process, Becker has made himself a very rich man.

The $1 million that he and his associates paid out to buy Franklin Life in 1939 has grown to some 1.1 million shares worth over $85 million in today's market. [Author's note: $150 million in 1962's market.]

Charlie Becker owes his success to a firm grasp of the economics of one of the least understood but potentially most lucrative corners of U.S. industry. Insurance is no ordinary business. Working on behalf of the stockholders of the life insurance companies are a combination of potent factors: high leverage, low taxes, rising interest rates and a growing population whose pocketbooks are getting fatter and fatter and whose life expectancy is lengthening.

Franklin Life, for example, has total assets of $470.4 million. Of this, only $54.8 million represents the equity of the common stockholders; almost all of the balance represents reserves built up out of premiums paid in by policyholders insured by the company.

Franklin Life had to pay out less than 30% of the premium money in benefits to families of policyholders who died. Another 9.5% went in dividends to policyholders. After agents' commissions, that left a very solid 48.6¢ on every premium dollar, or $45.1 million, to plow into reserves and surplus. Theoretically, of course, the reserves were there for protection of policyholders; in practice, they were piling up earning assets which ultimately benefit Franklin Life's common stockholders.

To get top earnings for salesmen and stockholders, Becker concentrates on the more profitable lines of life insurance.

Read carefully, now. Don't miss this:

Franklin now ranks as the U.S.'s largest writer of ordinary life alone.

"Why do we write only ordinary life? Because that's where the profit is," grins Becker. "With the high-premium policies in which we specialize, I can afford to pay our agents top commissions and still generate high profits for our stockholders."

What about those facts? Less than one third of the premiums paid by policyholders has to be paid out in benefits to policyholders. Says *Forbes,* "Another 14% goes out as agent's

commissions." The company sells cash value insurance because "that's where the profit is."

A lushly printed book, paid for by the policyholders of National Life of Vermont and containing what I regard as an astonishing collection of financial misinformation, ends by calling upon the insurance fraternity to "confidently demonstrate with increased vigor the true value of life insurance and *that means life insurance with substantial cash values.*" (Italics added.)

Commissions Again

If you apply for new life insurance and the company issues a policy with an extra premium or "rating" because you are not in perfect health, the agent will receive a larger commission. Why should an insurance agent be rewarded with extra commissions because your health is not perfect? People with health impairments are not harder to sell. If anything, they are easier to sell and a reduction in the commission might be more appropriate.

If an agent sells two men, one aged 35 and the other 45, he receives a larger commission for selling the older man. Why should his commission not be related to the product he sells rather than to the age or physical condition of the buyer?

A life insurance agent should be paid a commission for selling you $1000 worth of protection—and that commission should be the same no matter what type of policy he has sold you. If this system of compensation were in effect, what kind of life insurance would the agent urge you to buy? Term insurance, of course, because that would provide the largest number of thousands of dollars of insurance.

Actually, now, don't you *want* the most protection that you can get for your money? Wouldn't a method of agent compensation which made the agent's best interests jibe with your own (just for a change) be more likely to result in your having a suitable insurance program?

With the first premium payment you make on an ordinary life policy, you are prepaying a portion of the premiums which will be due on the policy during the latter half of its lifetime, for under the level-premium system of modern life insurance, you pay an "average" premium.

Thus, the agent receives as his first-year commission a part of the *advance* premiums you are paying. If at age 65 you

decide you no longer need the protection and take the cash surrender value of the policy, you'll get back some of those advance premiums, but you won't get *all* them back because part of them went to the agent the very first year.

The point is that while the agent is entitled to receive a commission on the premium for putting your insurance in force, he certainly isn't entitled to a commission on the money you are giving the company to hold just to make the cost of insurance less burdensome when you are very, very old. This money has not yet been applied toward the purchase of protection. The company is simply holding it, and when the premium is due it will be used to make up the deficit between the premium you pay that year and the actual cost of protecting you at that attained age. The agent should not be paid a commission on it until it is so used.

Let us suppose that you arranged to pay the insurance company each year the actual cost of insuring you that year, and you deposited the money for advance premiums in a savings bank instead of with the insurance company. The agent's commission would be simply a percentage of the cost of the first year's protection. He would get no part of the advance premiums held by the savings bank. Whenever you died, your family would have *all* of the insurance plus *all* the money you had put aside in the savings bank for future premiums which had not been used when you died. If you decided to terminate the policy at age 65, you could withdraw all of the money you'd saved for future premiums from the bank. It would all be there because no agent's commission would have been deducted from it.

Paid-Up Insurance

If you buy a 20-payment or 30-payment life or a life-paid-up-at-age-65 policy, you are prepaying future premiums to an even greater degree. Under those policies, you don't just keep your out-of-pocket premiums down to a moderate rate in your later years, you eliminate them altogether. You do this by accumulating a cash value/savings account large enough so that the interest it earns will be sufficient to pay for whatever life insurance is still in force after you have ceased premium payments. Remember that the life insurance in force is reduced considerably because it is equal only to the difference between your cash value and the face amount of the policy.

It's one thing to prepay the premium itself. It's quite another to accumulate enough capital so that the *earnings* from it will be sufficient to pay the premiums then due. This requirement that you accumulate capital inflates the premium right from the start. Under these policies, then, you actually pay far more in advance premiums and investment than you do for protection the first year. The agent doesn't get paid just for selling you the protection, though; he gets his cut out of the advance premium and investment as well. It therefore becomes a more desirable policy from the agent's standpoint and is more likely to be enthusiastically recommended by him.

Never forget that if you own a policy which runs through to age 96 or 100 (that is, an ordinary life or limited payment life policy) the very high premium rates applicable to insurance coverage after age 75 must be included when the company is averaging your lifetime of premiums to establish the level premium you must pay under the policy. If, as is very likely, you are going to terminate the policy at age 65 in order to gather together all available funds for retirement purposes, you won't want the high-cost protection in your years after age 65. Those high costs will have been averaged into your premiums, though, and the agent who sold you the policy will have received a commission for them.

If you are able to shake off the motivation, subliminal and otherwise, of which the Institute of Life Insurance boasted a few pages back, why not write them at 488 Madison Avenue, New York City, next time you see a big full-page spread in a newspaper or magazine extolling the merits of their submarginal savings plans, their "living insurance," and ask them what the campaign is costing you and your fellow policyholders? For a change, let Big Brother know that *you're* watching *him*.

Insurance men have always made much of the fact that life insurance cash values are immune from liens or attachments of any kind. You may wish to note that Uncle Sam holds a contrary view—the Internal Revenue Department, supported by two court decisions, has successfully filed tax liens on such values, contending that while the cash surrender value is not the property of the insured, it is nevertheless property to which he has a claim and which he can reduce to possession, and it is therefore subject to a federal tax lien. It seems only a question of time before others will claim that giving Uncle Sam this preferred status is discriminatory

and illegal and life insurance cash values will be attachable by anyone. Here again we see the obvious advantage of term insurance, which has no cash values exposed to attachment. To a man in difficulties, a term-insurance estate is preserved because it offers no invitation to creditors, while an estate composed of cash value policies may be emasculated, even destroyed.

Here, then, is the essence of my argument in favor of term insurance: It isn't just a question of saving a few dollars by buying one form of policy rather than another. Rather, it is a case of the popular, much-merchandised form of "permanent" cash value insurance having failed over a period of more than a century to provide adequate protection early in life when it was needed or adequate retirement security later when that was needed.

Chapter 14

Types of Policies: I

We have established that there are just two kinds of life insurance: term insurance and all other kinds. Term insurance is pure protection; the "other kinds" all consist of some combination of term insurance plus a savings account. Chart 2 illustrates term insurance in various forms and combinations.

Term insurance can run for a period of 1, 5, 10, 15, or 20 years or until age 65 or 70. The longer the period it is to run, the higher the premium per year per $1000 because the company is obligated to provide protection in the face amount for the whole period at the same initial rate. The premium for a 5- or 10-year term is less than that for a 20-year term, but whenever you renew it, the premium will jump.

Figure 1 in the chart illustrates straight or level term. The premium is fixed for the period the policy is to run, and the amount of actual protection provided is likewise constant.

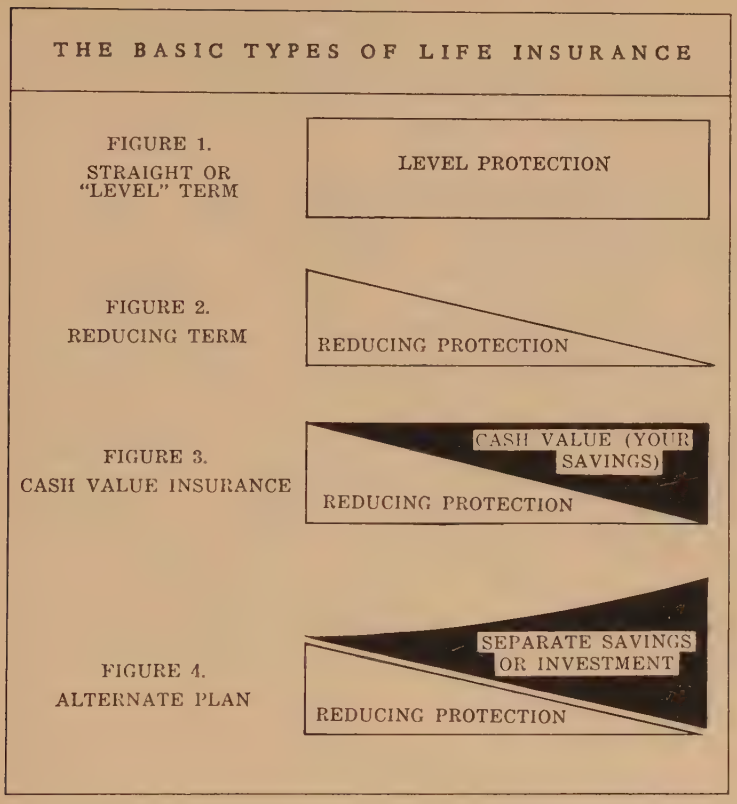
Figure 2 illustrates reducing term insurance. This, too, can be bought for varying periods of time during which the protection reduces while the premium does not. The premium is cheaper than that for level term insurance because as you grow older and the mortality hazard increases, the insurance reduces and the company is therefore gradually getting off the risk.

Figure 3 illustrates the "all other kinds" type of insurance—reducing term insurance plus a savings account/cash value, which increases gradually until at maturity it has completely replaced the protection element in the policy.

Figure 4 illustrates a suggested alternate plan which separates protection from savings and investment. The use of the alternate plan does not require additional funds as premiums for term insurance are 50% to 90% less than the premiums for equivalent cash value insurance. This difference—even at a modest 3¾% interest—will grow much faster if *not* included in the insurance program. For proof of this, see the individual policy charts in Chapter 26.

Let us next examine some of the varieties of insurance policies which are available.

CHART 2

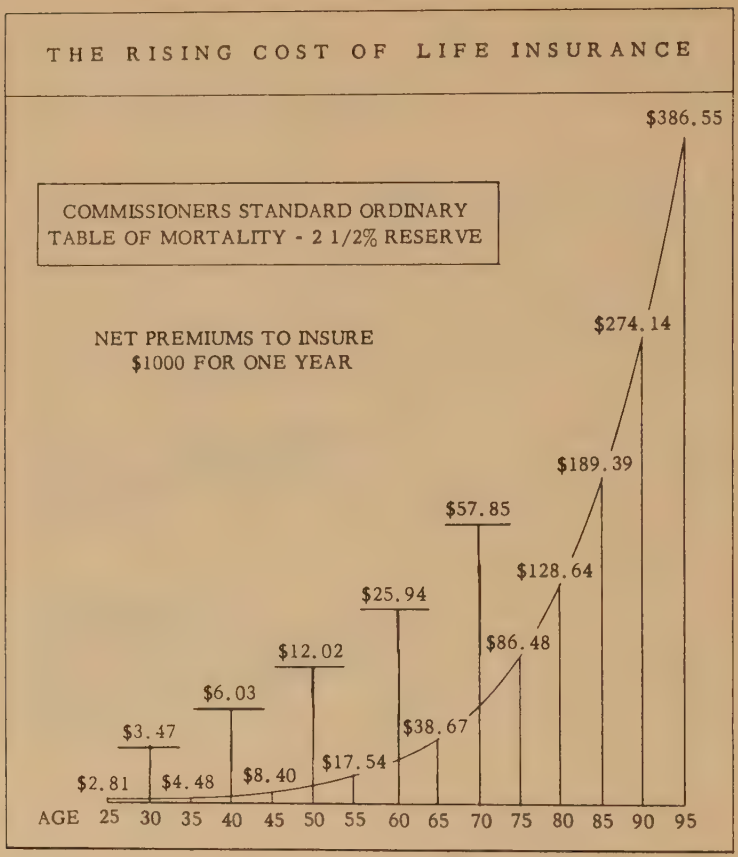


Ordinary Life

Sometimes called whole life or straight life, an ordinary life policy requires the lowest premium of the various types of cash value policies, the reason being that the premium payments are spread over all the years to age 100. At age 100, the cash value is exactly equal to the face amount of the policy. The face amount is paid to the policyholder and the insurance terminates. (The foregoing applies to policies being issued now; earlier ordinary life policies matured at age 96.)

For many years, when a man indicated that he wanted to buy ordinary life it was common for the company to sell him an endowment-at-age-85 policy. Since premiums on such

CHART 3



Mortality cost is the basic cost of all forms of life insurance. Since this is a rising cost, it is obvious that every insurance company must in some way *collect from the policyholder* an increasing amount each year as the policy grows older.

In cash value policies this is accomplished indirectly—by reduction in the amount of the net insurance at risk and from earnings on the cash value. The following example of an Ordinary Life policy issued at age 30 illustrates what has occurred between ages 30 and 65.

Face amount of policy	$10,000
Cash value at age 65	$5,800
Net insurance risk at 65	$ 4,200

Annual premium income	$180.00
Income on cash value at 4.22%*	$240.76
Total company income at 65	$420.76

*1961 Income—U.S. Life Companies

Company income per $1000 insurance: age 30—$18.00; age 65—$100.00

Mortality cost per $1000 insurance: age 30—$3.47; age 65—$38.67

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policies are payable only to age 85 and the policy matures at that time instead of at age 96 or 100, the premiums have to be larger and the cash value builds up faster. That was to the company's advantage. Actually, the insured paid a higher premium for the dubious privilege of concentrating his premiums in the years before age 85. In fact, the mortality table said he wouldn't live to that age anyway, so the advantage gained by paying the extra dollars was in most cases purely imaginary. The endowment-at-85 approach also frequently was used by the companies as a form of extra "rating" for risks considered medically substandard. The company would accept you—provided you agreed to the higher premium rate applicable to the endowment at 85.

Chart 3 illustrates the rising cost of pure insurance and relates this to the company's income on an ordinary life policy.

Limited Payment Life

This policy, like ordinary life, matures at age 100 (older policies at age 96) but premiums are concentrated within a specified number of years instead of spread over the whole life of the policy. The most popular form of this contract is the 20-payment life; other common versions are the 30-payment life, life paid up at 65, and life paid up at 85.

Why one should be so solicitous for the welfare of an insurance company as to crowd a whole lifetime of insurance-premium payments into the early years of a contract so as to save the company from all possible loss is beyond me.

Actually, the popularity of this type of contract is due largely to the adroit way in which it is presented by the agent to the prospect: "Wouldn't you like to get your premiums out of the way during your earning years?" That sounds good. Naturally, the shorter the premium-paying period, the larger

the premium. The larger the premium, the larger the commission and the faster the cash value accumulates—the cash value which will help pay the claim if you die. The faster the cash value accumulates, the better the "net cost" illustration can be made to look. It often ends with the buyer actually imagining that he's getting something for nothing.

A leading life insurance journal published an article by Seth C. Macon, superintendent of agencies for Jefferson Standard Life, in which the author reminded agents that "The agent selling Life Paid-Up at 65 instead of Whole Life can increase his income from 10 to 20 per cent on the same volume of business."

You may wish to bear this in mind when next you are solicited by an agent for a life-paid-up-at-65 policy.

Is a paid-up policy ever really paid up?

On page 187 is an illustration of the way the cost of a typical paid-up life insurance policy continues to increase each year, even though no more premiums are being paid on the policy, and a comparison of that cost with the unpublicized actual cost of pure protection in the same years.

These figures show that there is just no such thing as a paid-up policy.

Endowments

Policies which provide for the savings account to mature early enough for the purchaser to have some reasonable hope of living long enough to get his savings account back are called endowments. The most popular types are the 20-year endowment and the endowment at age 65. There is also the endowment at age 85, discussed a paragraph or two back. One policy which I examined recently was labeled "endowment at age 95." It was a policy written a decade ago, when ordinary life was an endowment at 96. Rather than identify it frankly and forthrightly as an ordinary life contract, however, the company advanced the maturity date a single year and boldly called the policy an endowment.

Policies sold to educate children are generally 15- or 17-year endowments—reducing term insurance plus a savings account which matures when the youngster is ready for college, from the standpoint of cost and return certainly one of the dreariest of all insurance policies.

1	2	3	4	5	6	7
Age	*Insurance in force*	*Policy cash value*	*3¾% policyholder's cash value could earn elsewhere*	*3¾% given up by policyholder added to $33.77 annual premium*	*Total cost per $1000 (column 5 divided by no. of 1000s in column 2)*	*Pure insurance cost per $1000*
35	$1000.00	None	None	$33.77	$33.77	$ 6.09
36	982.00	$ 18.00	$ .68	34.45	35.08	6.36
37	952.00	48.00	1.29	35.06	35.93	6.65
38	922.00	78.00	3.23	37.00	40.03	6.96
39	892.00	108.00	4.05	37.82	42.39	7.32
45	730.00	270.00	10.13	43.90	60.13	10.11
50	550.00	450.00	16.88	50.65	92.09	13.82
55*	346.00	654.00	24.53	58.27	168.40	19.78
60	295.50	704.50	26.41	26.41	89.37	29.25
65	264.04	753.96	28.26	28.26	107.02	43.60
70	200.63	799.37	29.98	29.98	149.42	65.23
75	159.69	840.31	31.51	31.51	193.19	89.99

*At age 55, the 20-payment life policy is said to be paid up, but the policyholder's cost—the loss of interest—continues.

Compiled by the author from various rate books.

Let's assume that you own a $10,000 20-year endowment policy—actually a 20-year reducing term insurance policy plus a savings account which will net you $10,000 at the end of the period. Each year you give the company the cost of the protection plus some extra dollars which are to be put aside for you until the end of the 20 years. You've had the policy 17 years. Your savings account with the company has accumulated to $8000. That's your money. You've paid for the insurance protection you have had; this is the accumulation of extra dollars which you need never have given the company in the first place.

Now you're in the insurance business. If you die, the company will add $2000 worth of insurance to your $8000 and pay the $10,000 total to your beneficiary. You carried 80% of the risk yourself while the insurance company carried only the other 20%. You might well ask yourself: "If the company is risking only $2000 and I am paying a premium of $480 this year, isn't that pretty expensive protection? Wouldn't I be better off to take out the $8000 and invest it conservatively? At 6% compounded, the $8000 will grow to $10,000 in a little over three years. Meanwhile, during the three years I'll make up the difference in protection by buying $2000 of term insurance which will cost me less than $40 a year instead of the $480 premium I am now paying. I'll have the same $10,000 of protection, my endowment will still be waiting for me where I have invested it, and I will have saved more than $1320 in premiums."

The American Institute for Economic Research says, in its book *Life Insurance and Annuities from the Buyer's Point of View:*

> The only justification for endowment insurance is that it provides a convenient method of saving for those who otherwise would not save.
>
> The purchase of retirement annuities or the high-priced endowment forms of insurance often will prove to be an unsatisfactory and expensive means of saving for retirement, especially for the man who can barely afford sufficient insurance protection for his family. For the man whose income and insurance coverage are more than enough for the care of dependents, investment in other than endowment insurance probably will prove to be more satisfactory in the long run.

The president of one of the large insurance companies contributed an article to one of the leading financial journals extolling the virtues of the 20-year endowment policy. In an article in the following issue, I challenged him to present evidence that he himself owned a 20-year endowment, offering to send $100 to his favorite charity. He didn't take me up on it. Perhaps he had no favorite charity.

I challenge any insurance agent in the country to present documentary evidence that he owns a 20-year endowment policy. My contention is that they don't buy them; they just sell them.

Retirement Income Policies

These policies consist of reducing term insurance plus a savings account which matures at age 55, 60, or 65 and is automatically applied to the purchase of an annuity with 100 or 120 months' payments certain—that is, if you die before you have received the 100 or 120 monthly checks, the company will continue them for the balance of the 120 months to a named beneficiary or discount them and pay off the balance of the 120 payments in one lump sum. These policies were popular during the depression years, probably as a reaction to the speculative era that ended in 1929. As time has passed, and particularly during the past ten years, people have become financially more sophisticated, more conscious of inflation's inroads on the purchasing power of the dollar. The result has been a general turning away from such policies, although the companies continue to push them where possible. Phoenix Mutual continues to run its traditional advertisements about "How I Retired with $100 per Month," except that now the ad suggests $300 per month. The most effective arguments against such policies are the advertisements offering them. By their constant boosting of the suggested retirement income, they direct attention to the greatest weakness of this type of policy—its vulnerability to inflation.

No one will quarrel with the idea of providing protection for one's family while at the same time accumulating a fund for some such purpose as education or retirement. But if you try to do both of these jobs through the medium of one insurance policy, it is likely that both jobs will be done badly.

A friend of mine, a well-known educator, purchased a retirement-income-at-65 policy from Phoenix Mutual back in

1931. She faithfully paid the premium of $242 per year for 30 years, a total of $7260. Finally, in October 1961, the policy matured. As a result of having left dividends to accumulate at interest for 30 years, the $75 per month which the policy guaranteed to pay was boosted to $77.63 and in October Dr. S began to receive her income checks. In March 1962, four months later, she died. In accordance with the policy guarantee of 100 months' payments certain, the company will continue the checks to her beneficiary for another 96 months. The total amount Dr. S and her beneficiary will have received from the company thus becomes 100 times $77.63, or $7,763. The company had the use of the money for nearly 40 years as it was being accumulated and while it was being paid out, and the total gain realized by the beneficiaries was $503.

If Dr. S had put the premiums in the savings bank for 30 years at only 2½% interest, they would have accumulated to $10,620, representing a profit of $3360, or six times the profit provided by the policy. With its emphasis upon cash value, the policy provided negligible protection during much of the 30 years and none at all during the last 12. Yet insurance men claim life insurance is a good investment.

In a recent year, 36,000 retirement-income policies went off the books of one company. Nine thousand of these were death claims or matured policies. The other 27,000 were surrendered by policyholders discouraged by the decline in purchasing power of the dollar and disillusioned with a policy which promised a degree of financial security more apparent than real.

Viewed solely as life insurance, the retirement income policy is expensive protection. If the policyholder dies prior to retirement date, the plan becomes a contract of life insurance at an extravagant premium. For pure protection—term insurance—the same company requires only a sixth of the premium required for the retirement income policy. The premium difference is necessary not to cover the risk of dying but to build up the cash sum required to provide the annuity guaranteed at retirement age.

A life insurance contract is obviously a long-term obligation. Since the history of our country is one of booms and depressions, it would seem prudent to keep one's fixed, inescapable commitments at a minimum. If one buys a given amount of pure protection at $250 per year premium instead

of a retirement income policy offering an equivalent amount of protection for a premium of $1000, one can save or invest the $750 difference elsewhere. Then during a possible depression, one can keep one's life insurance estate intact by paying only the insurance premium and foregoing the investment. Committed to an inflexible $1000 per year, one might easily end up losing everything, including the protection, as has happened to so many.

Viewed solely as a savings medium, the retirement income policy is far from attractive. It obviously lacks the liquidity of a bank savings account. On average, it is fourteen years before the cash value of the policy equals the deposits. A careful analysis of the policy discloses that the "profit" it produces at maturity, after making suitable allowance for the insurance protection provided, represents a return well below that obtainable in a savings bank. As for the annuity income with its guarantee of 100 or 120 months certain, we have seen what this amounted to in the case of my educator friend. It is wishful thinking for the average individual to hope to live long enough to retrieve his premiums plus some small interest. The income return on annuities is now the lowest in history. This fact, together with the continued long-term rise in the cost of living, makes the rigid and fixed income from annuities impractical for most people. In any event, annuities should be purchased only by those advanced in years and in the best of health.

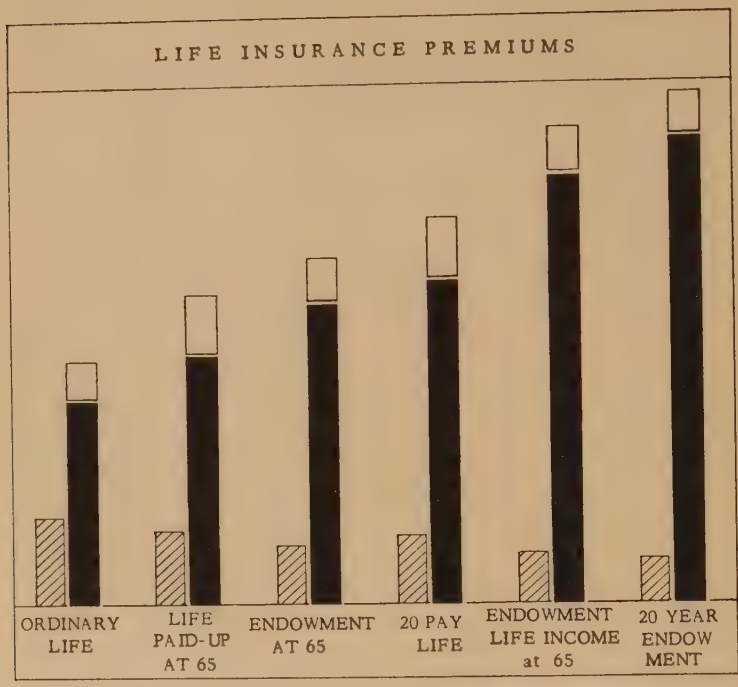
Chart 4 illustrates the premium differences between term and cash value insurance. Charts 5 and 6 give a pictorial presentation of the "reducing term insurance/increasing cash value" arrangement as it operates with various types of policies from age 35 to age 65.

A leading insurance executive has said that life insurance hasn't changed in two centuries, that all the policies presently being sold are merely retreads of the same old ordinary life, limited payment life, and endowment policies.

The French have an exciting way of disguising economy cuts of *boeuf* beneath a variety of sauces. The end result may have plenty of eye appeal and an air of mystery, but if you push aside the sauce and confront the remains of a beast who died of old age, you may resolve forever after to stick to a good, honest piece of meat which needs no disguise.

Home-office sales psychologists are the chefs who concoct the sales promotional "sauce" to disguise and make tem-

CHART 4



The above chart illustrates the great difference between the premiums charged for six typical cash value policies and the premiums charged for equivalent term insurance

CASH VALUE POLICIES

Black bars—premiums for nonparticipating policies.
White bars—extra charge for participating policies.

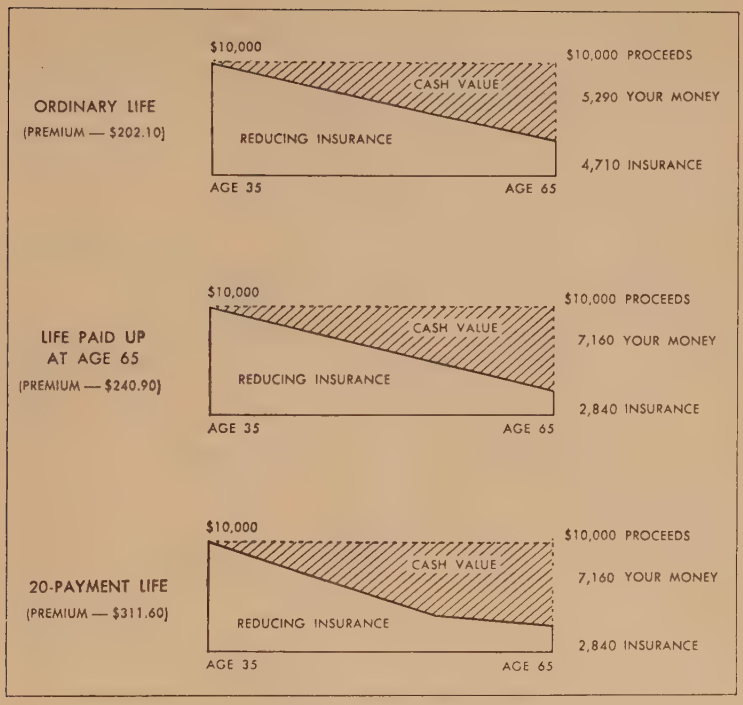
PURE TERM POLICIES

Striped bars—premiums for equivalent term insurance.

porarily palatable a lot of tired old insurance contracts. You can't make a meal out of such sauce, though, and the chances are that when you find a horseshoe nail in the insurance "boeuf," you'll head for another restaurant. The insurance chefs all went to the same cooking school, however, and they all try to palm off on you the economy cuts on which they make the most money.

Next time, ask for the à la carte menu, point to "term in-

CHART 5



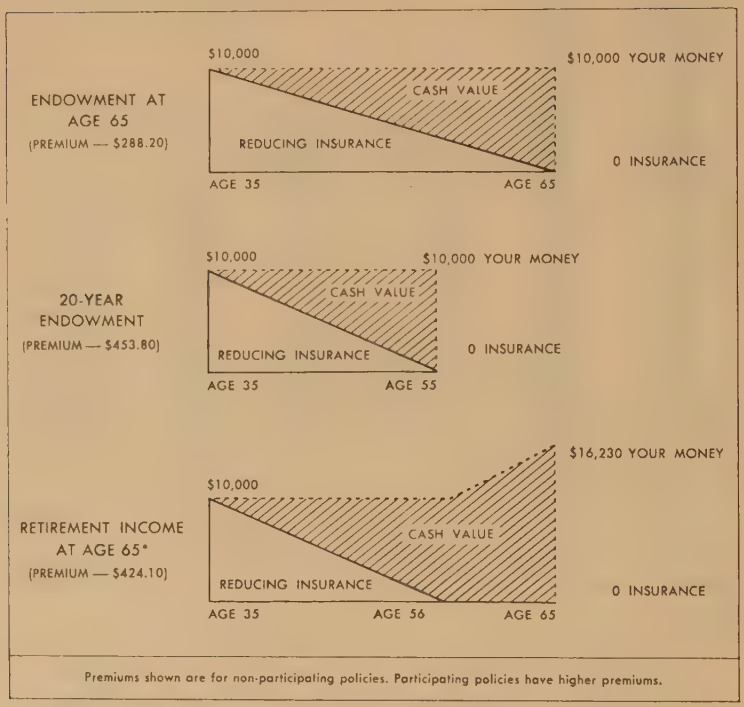
surance" and say, "I'll have that, medium rare—and no sauce!"

An item in *The New York Times* reports:

> A life insurance company has added an Old World touch to one of its policies by including a marriage expense, or "dowry," plan.
>
> The John Hancock Mutual Life Insurance Company is offering the plan in its children's education-expenses policy, under which the face amount is paid in eight semi-annual installments, beginning six months after the policy anniversary nearest the insured's seventeenth birthday. On policies written on a child under 6, the insured would receive the face amount, or the balance, if she (or he) married between the ages of 18 and 21.

An "Old World touch," eh? I can think of another meaning of the word touch. What kind of mortality table do they use to measure the possibility of the pride of the family getting married at 18 or 19 rather than at 20 or 21? If Marybelle and her young man decided to strike out on their own now instead of waiting another year or two until he's old enough

CHART 6



*Purely for convenience in selling, retirement income policies arbitrarily provide a $10 monthly annuity beginning at maturity for each $1000 of protection. A $10,000 policy thus provides a $100 monthly retirement income. Actually, it requires $16,230 to provide an annuity of $100 monthly beginning at age 65. The insurance company must therefore see to it that the retirement income policy has a cash value of $16,230 at age 65. This is accomplished by charging enough extra premium to fatten the cash value in the later years. Note on the chart that the effect of this is to eliminate the protection element of the policy many years ahead of its actual maturity.

to get a credit card, the John Hancock has to get it up now, not two or three years from now when Marybelle is 21. This is life insurance? This is sauce—hiding a two-century-old 15-year endowment. Dowry? Pshaw!

The Hancock chefs have been working overtime. An article in *The Insurance Field* reported that 7 million Hancock industrial policyholders would receive increased life insurance coverage at no cost to them. It turned out that they were going to have triple indemnity added to their policies. This means that if they die as a result of injuries sustained while traveling as a passenger on a public conveyance, their families will collect three times the sum insured. I don't understand the reasoning which concludes that if you come to an untimely end on a bus, your family will need three times as much insurance as if you expired peacefully at home from overeating. Actually, from a financial point of view, there are few nicer places to die than on a public bus—they carry fabulous insurance policies. Bear in mind that these 7 million happy people to whom Hancock has given "increased insurance coverage" are industrial policyholders. They own small policies calling for $100 to $500 of insurance with premiums of 5¢ to 50¢ collected weekly at their homes. They're not likely to be riding in airplanes or taxis. They may very well drive their own car to work and to the beach on Sunday. But this wonderful "additional insurance protection" can pay off only when riding in a public conveyance. That announcement involving 7 million people got the John Hancock a million dollars worth of publicity—and I'll bet they don't pay two $250 claims on it in the course of a year.

Here's a real prizewinner, Berkshire Life's "Magic Endowment," which is described as

> . . . essentially an Endowment at Age 65, with premiums limited to age 40, or for 20 years, whichever is longer. It includes four options available on first marriage before age 40.
>
> 1. Buying additional insurance up to twice the original amount, on a permanent plan without evidence of insurability within four months of marriage.
> 2. Change without evidence of insurability to Life Paid Up at Age 65 for issue ages 0–14 and to Ordinary Life for issue ages 15 and over, with the cash value difference paid in cash.

3. Purchase of permanent insurance, without evidence of insurability, for half the amount of the husband's policy.
4. Continuation for a reduced premium after the policy is paid up and thus maturing the policy at age 65.

This actuarial monstrosity is enough to give an old-time actuary the heebie-jeebies. I wouldn't be a bit surprised if the American Society of Actuaries wired the company, "What in hell's going on up there?"

Berkshire's president Rankin W. Furey told the American Life Convention: "Under the old system, we knew exactly what we were dealing with. Under the new system, there are problems, variables. Widely changing margins are introduced and present costs become increasingly difficult to figure and plan."

I don't wonder, with that "Magic Endowment." That's a real generous serving of "sauce."

Modified Life Policies

Though insurance agents loathe term insurance, they frequently encounter a prospect who, needing protection, cannot pay for the "permanent" insurance the agent recommends. In this circumstance, the modified life policy is generally suggested. This is a policy which runs for 3 or 5 years as term insurance with appropriately reasonable premiums and then automatically converts to ordinary life with a substantially higher premium. The good part of this contract is the term insurance, but this is lost via the automatic conversion. Avoid the modified life policy and stick to either renewable term or term which runs right through to age 65.

Family Income Policies

This is another hybrid, an ordinary life policy with an extra reducing term rider, the latter generally running for 15 or 20 years from the date of issue.

There are two versions of this policy. The one most frequently encountered provides that upon the death of the insured, the proceeds of the ordinary life part of the policy shall be held by the company for the balance of the family income period—that is, until the fifteenth or twentieth anniversary of the issuance of the policy—with interest being paid

on it meanwhile. The proceeds of the term insurance rider are paid to the beneficiary in the form of a monthly income. The amounts of insurance involved are so computed that on a $10,000 family income policy the monthly payment of the term insurance rider plus the interest being paid in cash on the ordinary life part of the policy which is being retained by the company totals $100. In other words, a family income policy pays your beneficiary $10 per month per $1000 of face amount for whatever balance of the family income period remains, and then pays your beneficiary the $1000 ordinary life proceeds.

Too often, a family income policy is represented as being worth the sum total of the ordinary life face amount plus 20 years' income payments. This is a fallacy, of course. Assuming a 3½% interest factor, $1000 payable 20 years hence is the equivalent of only $503 payable now. Similarly, $10 per month for 20 years is not $2400 but only $870 if the company earns 3½% interest on the funds remaining in its hands. A family income policy is a rather difficult thing for a layman to assess, then.

A few family income policies pay the face amount immediately instead of deferring it until the end of the family income period. Naturally, the premium is higher on such policies.

It is customary for such policies to include a clause giving the beneficiary the right to commute the payments—that is, to elect to be paid off in one lump sum instead of taking the deferred income and final lump sum. Some companies require the insured to file written approval of this provision to make it effective. Others declare it effective provided the insured has not filed with the company a written instruction that the beneficiary may not commute.

If you have this type of policy, read it very carefully or take it to someone who can examine it for you. Make sure that payments can be commuted. Write to the company and ask them to confirm in a letter that your beneficiary can receive the whole amount in cash at your death. Don't just depend upon your interpretation of it.

I looked at Metropolitan family income policies for years before I finally noticed a tricky clause which said that it could be commuted but that the beneficiary could obtain only one quarter of the commuted value in cash; the rest had to be taken as income. This is plain deception. They say: "You can

commute the payments, but you may only take a quarter of the commuted value." Why don't they say "You may commute only a quarter of the family income payments on this policy"?

Why do people buy a family income policy? Well, principally because of the extra protection it gives via the rider. What makes the rider so good? Why, because it's term insurance. If the policy is good because it provides some extra protection in the form of term insurance, wouldn't it be better still if it were *all* term insurance? Well, then, why don't you take it back to the company and ask them to convert the whole thing to term insurance? You say that you were thinking of doing just that? Well, good!

Just so you won't fall for anything that looks like term insurance but is not, let me reprint here a little item from the *National Underwriter:*

> Mutual of New York has introduced a permanent life policy priced in its early years to compete with low-cost term insurance.
>
> The new policy is based on a premium rate schedule which holds down the premiums in the early years and gradually increases them later, when the policyholder's income presumably will be larger. The schedule is designed primarily for young married men with large responsibilities and limited income.
>
> The first year premium is about the same as that for a 20-year term policy and increases about 10% each year for ten years and then levels off.

Pretty sneaky, eh? They lull you with a low term-insurance rate, ease you into this financial quicksand and, before you know it, there you are building the old cash value and joining millions of others like you on the "permanent insurance" treadmill, building a "savings account" which death will destroy in an instant.

Mortgage Protection Policies

These policies, sold by most companies, are simply reducing term insurance—and very good. Some companies will talk mortgage protection and actually deliver to you a family income policy with the assumption that the beneficiary will

commute the payments and use them to pay off the mortgage. The disadvantage of this is the disadvantage of all family income policies—they are principally ordinary life. There was a time when the companies paid no commissions on the term insurance rider on a family income policy. As the field force has grown in numbers and in power over the home office, it has insisted upon the abandonment of this practice. The family income policy and this type of mortgage protection policy have therefore lost a small advantage which they once had.

There is one little gimmick in mortgage protection policies which you should watch for and avoid; that is the practice of limiting the premium-payment period. If you buy a reducing term insurance policy, it provides a constantly diminishing amount of protection to an agreed date. The premium does not reduce as the protection reduces. You are obviously paying more each year per $1000 of insurance actually in force, but this is taken into account in setting the premium rate—reducing term is far cheaper than level term.

Many people whose reducing term policies are in the final years will note that the protection is now relatively small while the premium remains undiminished. They therefore decide to give up the policy. There's no reason why they should not do so if they feel that they do not then need what protection remains in it.

Some companies sell a 20-year mortgage protection policy on which premiums are paid for only 17 years. Some 25-year policies provide for premium payments for only 20 years. What you are doing is concentrating the 25 years of premiums into the first 20 policy years. If you decide in the twentieth year that you will give up the policy, the company just grins and says, "That's all right with us. You're paid right through to the twenty-fifth year, though." Avoid these "limited payment" reducing term insurance policies.

Juvenile Insurance

While the obstetrician is washing up and taking off his gown, the insurance man lurking outside the maternity ward freezes in a perfect "point" at the happy father. Often, before the delirious parent knows what he is doing, he has purchased a 20-year endowment on the newborn child.

The sale of insurance on the lives of children has shown a

tremendous increase in recent years. A typical arrangement is a $5000 20-year endowment on the life of a newborn child with a premium of $233.20 per year plus a "payor protection" rider for an additional $18.65. This rider provides that premiums on the child's policy will be waived if the parent dies during the 20-year period. This is silly. The premium on an endowment is determined not so much by the age of the insured as by the fact that an agreed cash value must be accumulated within a specified number of years. There is very little premium saving involved, then, in buying the policy on the child instead of on the father. By adding the payor-protection rider, the total premium is raised to $251.85 per year, whereas the father could have bought the same 20-year endowment on his own life at age 35 for only $236.05. Under the child's policy, if the father dies in, say, the fifth year, the child receives no payment of any kind from the insurance company until the policy's twentieth anniversary. If the father had bought the endowment on himself and then died, the insurance money would be available to the child immediately.

Insurance should be on the parent. Insure the breadwinner, not the dependent. If something happens to the child, the father will not be seriously hurt financially. If the father dies, the child is probably in economic trouble. I have seen a number of instances where there was more insurance in force on a child than on the father. What kind of insurance counseling is that? Until such time as the head of the family has all the insurance he needs to take care of the family in case he dies—and this happy state is seldom achieved—any premium dollars available should be spent buying insurance on his life.

This brings me to another point, the practice of buying insurance on children when they're young so they'll enjoy a "cheaper" rate all their lives. The most charitable thing to be said about insurance men who talk this drivel is that they don't know what they're selling.

The death rate at early ages is obviously lower than at older ages. Insurance men imply, though, that having bought it young, you continue to enjoy a "cheaper" rate all the rest of your life. Nothing could be farther from the truth. Premiums are based upon mortality. Mortality increases with age. Ergo, premiums must go up as you get older. Of 100,000 men aged 35, x number will die this year. Therefore, all men aged 35 who are being insured must chip in enough to pay the claims

of those in *their* age group who die this year. Of 100,000 men aged 36, a slightly larger number will die this year. All the men in the age-36 group who are being insured must therefore chip in a slightly *larger* amount to pay the claims of those in *their* age group who die this year.

The premium charge per dollar of insurance in force for any specific age must be the same for all similar policyholders that age, irrespectively of when they bought their policies. All policyholders aged 40 pay the same cost of insurance—if there is a difference between the premiums paid by two such policyholders, it is because there is a difference in the amount of insurance in force. The man aged 40 who has a $1000 policy taken out at age 20 has a $300 cash value. The company is therefore giving him only $700 of protection. He pays less premium on this old policy than he would on a new policy simply because a new policy would require the insurance company to provide a full $1000 of protection, whereas under the old policy the company risks only $700; it has already collected the other $300 from him. The old premium is only 70% of the new premium because it is buying only 70% as much protection.

Buying insurance on children years ahead of their need for it is like buying fire insurance on a house before you have a house. Even if it *were* cheaper you'd be silly to buy it because nothing is a bargain if you don't need it.

Family Policy

If you have five kids, you might check into a family policy (not to be confused with the family *income* policy already described). This provides $5000 worth of insurance on your life, $1250 on your wife (provided she's the same age) and a like amount on each child. If you have a large family, this could be a bargain—particularly if you're fortunate enough to live in a state where savings-bank insurance is sold.

The disadvantage of the family policy is that it requires you to buy ordinary life on yourself. The advantage is that it puts term insurance on your children's lives. Most companies won't sell term insurance on people under 21; a handful will go down to age 15. If you have only two or three children, you're better off buying term on yourself and your wife and ordinary life on the kids if they're too young for term. When they reach 21, take the ordinary life policies

back to the insurance company and convert them to term insurance.

There is an interesting new development in the insurance field which constitutes an exception to my statement that you can't buy term insurance on young children. One company has brought out a single-premium term-insurance policy for children. For one flat charge of $60 the company will insure your child at any age (assuming that he is insurable) for $1000 until he is age 21. They will also guarantee to sell him $5000 of insurance then and similar amounts at 3- or 5-year intervals over the following 20 years without evidence of insurability. This seems a sensible plan. There are several versions of what the industry calls the "jumping juvenile" (a policy providing increased protection later on). To my knowledge, this is the only one which offers term coverage.

Except for this particular term insurance plan for youngsters, *single-premium life insurance* should be avoided at all costs. Invest the single premium and use the income from the investment to pay the annual premium on term insurance. If you die, your family will have the money you invested plus the term insurance. A single-premium policy is just limited payment life brought down to its irreducible minimum —one premium.

Chapter 15

Types of Policies: II

In the preceding chapter we discussed the retirement income policy, a contract which provides $1000 worth of life insurance plus a retirement income of $10 per month beginning at age 55, 60, or 65. We observed that this type of policy is at the mercy of inflation and noted that thousands of such policies have been abandoned by people who had come to realize that a guarantee of so many dollars per month is worthless unless one knows how many pounds of butter and pork chops the dollars will buy.

As people have become more sophisticated financially and have come to realize the fact that annuity policies of this type are particularly susceptible to the erosion of inflation, the life insurance companies have seen increasing numbers of policyholders turn away from retirement income policies and toward mutual funds and other investment programs which give their dollars a fighting chance against inflation. The life companies have been casting about for a way to deal with this menace.

Variable Annuity

This contract, one of the interesting answers they've come up with, is simply a combination of term insurance to age 65 plus an investment in a segregated portfolio of common stocks held and managed by the insurance company. There is no guaranteed retirement income. At retirement age the company will pay a specified number of dollars of monthly income for each $100 of cash value. The cash value will depend upon how successful the company has been with its common-stock investments of the reserves. There has been considerable opposition to the plan on the grounds that the insurance companies, traditionally committed largely to investment in debt obligations, are not particularly well qualified to manage a portfolio of equities. Its opponents also contend that such a contract is actually a security and that allowing it to be sold as an insurance policy, not subject to federal laws governing

the sale of securities, would invite misunderstanding if not misrepresentation.

Prudential has led the battle for the variable annuity, with its number-one rival, Metropolitan, saying it wanted no part of it. After three years of politicking, approval of the plan was finally rammed through the legislature of Prudential's home state, New Jersey. The Securities and Exchange Commission then notified Prudential that it regarded the plan as a security subject to the securities laws, not an insurance policy. The wrangle ended with a Supreme Court ruling that the SEC had jurisdiction. Next, Prudential applied for exemption from a number of requirements of the Securities Acts on the grounds that the contract was one issued by a company engaged principally in the insurance business rather than in the investment business. One of the things Prudential wanted to avoid was the necessity of delivering a prospectus to those who were going to buy. The SEC turned thumbs down on this, whereupon Louis R. Menagh, Prudential president, indicated that the company would drop its plans to sell variable annuities if forced to abide by the regulations applying to open-end investment companies.

At best, the variable annuity seems a clumsy duplication of the job now being ably done by the mutual funds. It might be well for prospective purchasers to consider that it is essentially an investment and that a historical record of demonstrated investment skill is the one most important factor to look for when selecting investment management. The variable annuity will be in the experimental stage for a long time. It would seem prudent to defer entering into such a contract until those who offer it can point to some concrete results instead of merely high hopes and good intentions.

The idea of a variable annuity is unquestionably desirable. The question is simply whether the insurance companies are the ones to manage such a program. Is the plan designed by the actuarial department or by the sales department? What is the company's motivation in entering the investment field?

Harold Franklin, president of the Association for Advanced Life Underwriting, as quoted in the *National Underwriter* (November 1, 1961), may offer a clue:

> We must be concerned that in the past few years the only new idea designed to bring life insurance companies more premium dollars is the variable annuity. Yet this is

stalled by the fight between the giants while the mutual funds reap the harvest.

There seems no particular expression of concern here about filling a need, unless it be the need of the life insurance companies for more premium dollars.

Douglas Thornsjo, writing in *Best's Life News* (October 1962), observed that

> Apart from the legal difficulties facing the variable annuity, or perhaps in part because of them, there is . . . a growing awareness that the variable annuity is not a particularly attractive product. First, the purchaser is charged a heavy sales load. Second, there is not the ease of redemption available with the traditional mutual fund.

Having noted these and other shortcomings of the variable annuity, Mr. Thornsjo observed that there nevertheless were many powerful companies interested in selling the policy and concluded with this very revealing comment:

> All of these companies have strong agency forces that will overcome any inherent defect in the product.

It doesn't matter, you see, whether the product is any good or not, just so long as there is a rip-snorting sales organization available to foist it on the public.

The companies who wish to offer the variable annuity propose to segregate the assets being accumulated as reserves against such policies. Henry F. Rood, senior vice-president of Lincoln National Life, warned the American Life Convention (*National Underwriter,* October 21, 1961), that the use of segregated accounts may invite "class" suits.

> So long as all policyholders are treated the same, as has been done in the past, there is little opportunity [for a policyholder] to win a suit claiming inequitable treatment. If one group of policyholders is given much better treatment because of capital gains in their equity account, great care must be taken that the rights of the general group of policyholders are not infringed upon to the extent that they could make a good case that their rights have been impaired and that they have not also shared in the good fortune of

the policyholders who have participated in the capital gains obtained in the stock market.

You will observe that the concern expressed here is not with the morality of giving a class of policyholders inequitable treatment, but only with the legal discomfort likely to result from being caught at it.

Rood added a curious afterthought:

> The purchase of large quantities of common stocks may have an adverse effect upon agents who have prided themselves on selling guaranteed benefits.

Imagine the plight of an insurance man who's been selling investment-type insurance all these years by rattling the bones of the 1929 crash at every opportunity, who now discovers that his very own company is readying a new plan under which the policyholder's premium money all goes into common stocks. Why, it's like suddenly coming upon your vicar tottering out of the local pub! It's getting so you can't trust anyone any more.

Mind you, I'm not saying that the idea of the variable annuity isn't a good one. Several such plans have been privately sponsored for many years, among them the College Retirement Equities Fund underwritten by the Carnegie Foundation to provide insurance and retirement security to educators. When Richard J. Congleton, general attorney for Prudential, was arguing before the Maryland State Senate Banking and Insurance Committee for the right to sell the variable annuity in that state (a move opposed by the state insurance department) he pointed out that persons participating in such privately sponsored plans were already receiving up to one and one half times the amount they would have received under the fixed-sum type of retirement annuities.

In mid-1962, the CREF itself issued figures which suggested that Congleton's illustration was conservative. Comparing the past 10 years' record of the two types of annuity, the fund cited the hypothetical case of a man who, at age 65 on July 1, 1952, made a lump-sum payment sufficient to provide him a guaranteed annuity return of $100 per month and put the same amount into a variable annuity. With allowance for dividends, he would be receiving $112 per month from

the guaranteed annuity and $298 a month from the variable annuity.

But how well would the insurance companies manage them and how would they sell them? The SEC called the Prudential plan, which Prudential proposed to offer without a prospectus,

> . . . a subtle and obscure device [that] comes to light only after long and close professional analysis. Under the circumstances it is difficult to see how the ordinary investor can ever be made to understand the inequality and discrimination which he may be buying without thorough, far-reaching disclosures to him which would be required under the regulatory supervision of the commission.

It goes without saying that the insurance companies would not be pressing for the right to sell a variable annuity if sale of the old standard annuity form was still good. It is not, of course. The following figures[1] tell the story:

Standard Annuity Contracts in Force

1952	1.279 million	1957	1.229 million
1953	1.279 million	1958	1.213 million
1954	1.267 million	1959	1.197 million
1955	1.252 million	1960	1.159 million
1956	1.239 million		

Note that despite the best efforts of the industry to write new standard annuity business, 1957 saw a loss of 10,000 contracts in force compared to the previous year. In 1958 the total dropped 16,000, in 1959 another 16,000, and in 1960 a whopping 48,000 net loss was recorded. Clearly, the annuity is losing its charm for Americans.

Retirement Income Annuity

One final note on the subject. There is a particularly obnoxious form of retirement income policy extant, the retirement income annuity which is identical with the standard form we examined earlier except that it contains no insurance pro-

[1] Compiled from *Life Insurance Fact Book (1961).*

vision. If you die, your beneficiary is paid the sum total of the premiums you paid (without interest) or the cash value, whichever is greater.

This policy is sold to people who have been medically rejected and cannot buy insurance or who, having no dependents, insist that they have no need for insurance. The insurance agent, hungry for a sale, palms off this lemon on them. I have talked with many owners of such policies who thought they had insurance.

The owner of one such policy had paid $700 a year for 5 years. There was no cash value whatever. If she waited 26 years, until she was 65, the policy would begin to pay her an income of $23 per month for life. What right does an insurance company have to tie up her money for a quarter of a century, to take it and refuse to return it? They offered her no prospectus. They withheld material facts about the policy. No one in his right mind to whom the facts about such a policy had been honestly presented would dream of buying it. Her only hope of getting something back lay in bringing an expensive lawsuit which would probably have taken a good bit of whatever she did get out of it. Why don't we have federal regulation to prevent unscrupulous agents and companies from preying on the public in this fashion?

Credit Insurance

An increasing amount of credit insurance is being sold. This insurance is written to cover a loan made by a bank or other lending institution. Not infrequently, credit insurance is a tip-off that the interest rates being charged are high, since the cost of credit insurance, generally about 85 cents per month per $1000, is absorbed by the lender. Exceptions are mutual-fund monthly investment plans of the type called contractual plans which provide for payments to be made over a period of ten or fifteen years. Since evidence of insurability is required, the carrying companies are able to weed out poor risks and the mortality experience under such groups is generally very favorable. The average cost of such insurance is therefore quite low.

The rate structure upon which such low-cost group policies are based is bewildering to a layman. Ostensibly, the underlying investment programs are sold to a cross section of Americans. A mutual fund in Boston has insurance coverage

provided by John Hancock at a flat rate of $3 per year per $1000 for all ages up to 60. At least nine other life companies underwrite similar plans for other funds at a base rate of $6 per year per $1000. Several funds offer investment plans with life insurance at $7.20 per year, and at least one has a flat rate of $9 per year per $1000. If Hancock can profitably provide the protection at $3 per year per $1000, how does one justify the other premiums which are 100% to 300% higher? It is difficult to understand how such widely differing rates can be set by underwriters all supposedly using the same mortality table. In any case, these mutual-fund investment plans with life insurance offer you an opportunity to buy life insurance at a rate far, far below what you would ordinarily pay for such coverage. It is reducing term insurance, too—the best kind. If you are in your fifties, they are a particular bargain since the rate is the same for all ages up to 60, which is the deadline on most such insured plans. One or two even permit you to open an insured account after age 60 if you deposit in it the amount you would have deposited by now had you taken it out on your sixtieth birthday.

Credit unions offer another form of credit insurance. They usually insure your life for an amount equal to your balance on deposit with them. If you die, your beneficiary receives your balance plus as much again from the insurance. If you borrow money from them, they insure you for the amount of the loan.

Split-Dollar Insurance

There is growing interest in this type of insurance. A corporation buys a $10,000 ordinary life policy on a valuable employee who is, say, age 35. The corporation pays the first annual premium and each year thereafter pays a portion of the premium, such portion being equal to the annual increase in the cash value of the policy. The employee pays the difference. The employer is at all times guaranteed the full return of its premium payments either by a beneficiary designation or by a collateral assignment equal to its payments. The employer can thus be assured that the exact amount of the premiums it has paid on the employee's behalf will someday come back to the company. If the employee dies, the amount of insurance left to his estate or beneficiary is the face amount less the collateral assignment to the employer.

The theory behind the plan is that initially and after the second year, the employee's contribution is relatively small. True, his insurance protection reduces steadily because he has assigned the cash value to his employer, but the protection is still a very big factor, especially in the early years. With many such policies, the employee pays no more premiums after the eighth year, the increase in the cash value then being equal to the premium. There is no mystery about this, of course. As thousands of dollars are accumulated in the policy reserve, these funds are credited with interest, albeit small interest, by the company. The cost of the protection is the amount being contributed by the employer plus the earnings of the accumulating cash value. The employer foregoes these earnings and instead makes a tax-free gift of them to the employee. The Internal Revenue Service has ruled that the money paid as premiums by the employer is not taxable income to the employee. On the other hand, if the employee dies and the employer receives the cash value from the proceeds of the policy, that money is not considered taxable income to the employer since it was in effect the employer's own money coming back.

Some insurance men contend, as we have noted, that the cost of term insurance purchased separately is higher than the cost of the reducing term insurance element in an ordinary life policy. They claim that in the ordinary life contract you are buying two separate financial plans, one for insurance and the other for investment. The commission and other costs of putting the "package" on the books is divided between the two. Because the acquisition costs are shared, they aver, the company can sell you the term insurance a little cheaper. If this be so, then split-dollar insurance should give you protection for less than you would pay for the same coverage direct, through term insurance.

Check this before you buy. Ask for a 20-year schedule showing the annual net cost to you after giving effect to the increase in the cash value which the company will pay. Next, get a 20-year schedule of death benefits—the face amount less the accumulated cash value which belongs to the company. Be sure that you get the figures from a stock company which can offer you a guaranteed cost. Now compare this cost with the premium for a 20-year level term on which you give up each year just enough of the protection to make it equivalent to the death benefit being provided that

year by the "split-dollar" contract. In this way you can make certain that the term insurance you are buying via split-dollar is cheaper than insurance you could buy on your own. Remember, the insurance you buy on your own is yours. You control it and you can take it with you if you decide to switch to another employer.

The disadvantage of an ordinary life policy is that it ties up some of the policyholder's savings along with the cost of the protection. If the extra dollars represented by the savings are not put up by the employee, that's another story. If you can get your employer to put up the difference for you, by all means do so. You have nothing to lose. If you leave the company, you can forget the policy. Your employer will cash it in and get his money back; you will have paid only for the protection you've already had. The employer cannot be hurt because he can always call the deal off, turn in the policy, and retrieve his premium money. The thing to be careful of is that you do not come to depend substantially upon the protection afforded by such a contract. If you decide to switch employers, you lose the coverage. If in the meantime you have become uninsurable, you will not be able to replace the coverage. You might then be faced with either taking over the high-premium contract with a policy loan to pay off your employer or buying it from him for the full amount of its current cash value. If you do that, you wind up with our financial polecat—cash value insurance. Split-dollar insurance is fine if it is an extra fringe benefit, a something-for-nothing deal.

Take advantage of the discounts available on larger policies. Some companies simply offer a special contract with a rather high minimum issue figure, which they sell at a lower rate. Others charge a low base rate per $1000 and then add a "policy charge" of a flat $10 or so. The extra charge can knock the bargain rate on term insurance to smithereens when you're buying only $5000 worth of coverage. The answer is: try not to buy a lot of small policies. Concentrate on large policies and qualify for a discount.

Industrial Insurance

The peculiar name "industrial insurance" is used to identify a class of life insurance which once was popular among people with very low incomes. These are the policies which were sold

for a premium of as little as five or ten cents a week. There was a time, a generation or two ago, when a $250 insurance policy would pay the funeral bills. Industrial insurance provided the $250. The industrial workers who bought such policies couldn't afford to pay the premiums for regular insurance. Industrial insurance was designed to make it possible for them to pay tiny premiums weekly to collectors who called at their homes—generally on pay day, before the money could be spent on something else.

Undoubtedly, in those days long ago, when industrial workers were poorly paid, industrial insurance served a useful purpose. It was a terribly expensive form of insurance, though. First it was assumed that, as a class, these buyers were poorer risks than other people. A special mortality table was designed which, because it assumed a higher mortality rate, called for higher premiums. Secondly, term insurance was not available. There were just two basic policies—20-payment life and 20-year endowment. Unfortunately, the two were so frequently confused in the minds of the buyers that it became mandatory to print a large legend across the face of the policy saying "This is a 20-payment life and not a 20-year endowment."

An important disadvantage of industrial insurance is that most such policies provide no cash value until premiums have been paid for five years.

The economic conditions which justified the sale of industrial insurance no longer exist. Individual earnings have long since risen to the point where any worker can pay for ordinary insurance. Spurred by unrelenting pressure from the insurance companies for continuing sales of industrial insurance, the agents have offered it to many persons for whom it was not economically suitable. Thus instead of selling the customer a single $1000 policy of ordinary insurance, an agent would sell him two $500 policies of industrial insurance. The premium for $1000 worth of industrial insurance would have bought $1500 worth of ordinary insurance. Having sold a policy calling for premiums of 25 cents or 50 cents weekly, the agent would then suggest that the customer avoid the nuisance of weekly collection by paying for one, two, or three months at a time. The customer who had bought industrial insurance with its weekly premiums inflated by the high costs of collection—would then actually pay those premiums at quarterly intervals which would have entitled him to lower-

costing ordinary insurance. Other insureds adopted the practice of paying their premiums in cash at the office at monthly or quarterly intervals. They, too, paid needlessly for the high cost of the collection services.

The industrial agent has a "debit," a list of customers, generally in the same neighborhood, whose premiums he collects. He must solicit them for more insurance and find other new customers in the same neighborhood. He is held strictly to account, and if an industrial policy goes off the books, he must replace it or suffer a reduction in his compensation. Each morning, the industrial agents are summoned into the manager's office, one by one, for a "morning report" of the business done the previous day. The pressure upon them is great.

Some of the sales devices used have bordered on the ludicrous. There are Abraham Lincoln Specials and George Washington Specials featured in February; Christopher Columbus Specials in October. However, the policies delivered in envelopes bearing the picture of the "patron saints" turn out to be the same old 20-payment life and 20-year endowments.

Despite the agents' best efforts, industrial insurance is on the wane, as indicated by this record[2] of policies in force:

1955	112 million
1956	110 million
1957	108 million
1958	104 million
1959	102 million
1960	100 million

The decline to 100 million policies in force in 1960 was in spite of the fact that the companies wrote more than ten million new policies! Each year more policies go off the books than are put on; in 1960, the ratio was eight to one. Generally speaking, people who have become uninsurable do not give up their insurance, however inequitable they may think it is. The people who are keeping their industrial insurance are therefore the uninsurable ones, resulting in a steadily increasing selection against the companies, a factor which must inevitably end in substantial dividend reductions on this type of policy.

[2] From *Life Insurance Fact Book (1961).*

Justice Brandeis campaigned against the unconscionable costs of industrial insurance a half-century ago. An economic dinosaur which stubbornly refuses to become extinct, it lingers on without justification in these modern times. Avoid it.

Monthly Debit Ordinary Insurance

Avoid, too, this hybrid half-brother of industrial insurance —monthly debit ordinary insurance. Monthly debit policies, written in amounts of $1000 to $7500, have premiums payable monthly and collected at your home by an agent.

A side light on the trend of the insurance business is offered by two bills pending in the New Jersey state legislature. The first would prohibit a company employing debit agents from establishing or enforcing new-business quotas or threatening such agents with loss of license for failure to bring in new business. The second provides that no policy for which premiums are normally collected by debit agents shall be permitted to lapse by reason of failure to pay the premium during an authorized strike by the agents.

Joseph MacLean, accepted by many as the dean of insurance authorities, says that the agents are "feeling their oats."

Group Insurance

Never lose an opportunity to buy group insurance. It is always a bargain.

There is far more competition between companies on group insurance than on policies sold to individuals. The average individual doesn't shop around for insurance; he buys from the agent who currently has drawn a bead on him. Group insurance is purchased by corporations or other organizations who take the time to look over the field and compare costs and benefits. Quite frequently, group coverage is put out for bids and the companies cut corners in every way possible to win the contract.

Group insurance ordinarily is term insurance issued without examination. This eliminates the fees of examining doctors. The insurance company doesn't issue complete policies to each individual insured; there is one master policy and the participants receive abbreviated certificates. This cuts down on policy issuance costs. No individual premium notices are involved; the insured employer sends one check for the lot.

The tremendous cost of processing periodic premium notices and receipts is avoided. They don't have to keep after people to pay the premium on individual policies; it's all handled automatically by the employer. All of these factors add up to important savings to the insurance company and contribute to the low price of group insurance.

So much for the advantages. About the only disadvantage of group insurance is that you don't control it. If your employer decides to do away with it, or if you move to another employer, you may lose your insurance. When you sever your connection with an insured employer, you have 30 days in which to request conversion of your group coverage without evidence of insurability to a plan of "permanent" insurance. They won't let you carry on with the term; they'll continue insuring you only if you will commit yourself to *invest* as well as *insure* over the years ahead. The only advantage of the conversion privilege, then, is that you don't have to present evidence of insurability. If you are in good health, there is no advantage in the conversion. There are many uninsurable people who obtain valuable protection by going to work for a firm that carries group insurance and then, when they leave, convert it to ordinary life, the cheapest form of cash value insurance. If you are uninsurable, don't hesitate —take the ordinary life, and as fast as the cash value accumulates take it out and invest it carefully where it will grow at a faster rate than it will in the insurance policy.

Don't make the mistake of thinking that you don't need to carry any insurance on your own just because you have a substantial group policy where you work. Remember, you can't take the group policy with you. Uninsurability may force you to accept the conversion to cash value insurance when you leave. Don't gamble. Forget the group insurance when you are figuring what coverage you need. Consider the group insurance benefits as gravy. Own life insurance that you control absolutely.

Many associations—medical societies, dental societies, etc. —have an opportunity to install a form of group insurance, called association insurance, for their members. Strictly speaking, group insurance requires an employer-employee relationship, but association insurance is expanding rapidly and low-cost coverage is being made available through more and more groups. The life insurance field men are bitter about it, claiming it robs them of commissions.

Deposit Administration

As the companies have seen more and more of the money which used to flow to them for group annuities under pension plans turning elsewhere—to trust companies and to mutual funds—they have cast about for a way to meet the challenge to their market and have come up with deposit administration, an arrangement not unlike the variable annuity. Under these policies the insurance company accepts sums of money from group retirement plans much as a trust company would receive them, agreeing to invest the money as best it can until an agreed future date, when the insurance company will commence annuity payments to the individual participants in the group. The exact amount of such payments is determined by the success of the company's investment efforts.

Much the same considerations apply here as in the case of the variable annuity. Investment management should be hired upon the basis of a proven record of successful investment performance over a substantial period of time. The life insurance companies were never designed to serve the purposes of trust companies or mutual funds. They are supposed to *insure*, to cover a *risk*; they are not primarily managers of money. Some life insurance companies own little or no common stocks and are therefore not qualified by experience to manage a portfolio of mixed bonds and stocks or of stocks alone. Because their obligation has always been in dollars, they never were required to seek out investments which would appreciate in value. They were investors in debt, and their responsibility was to place a dollar somewhere they would be sure to get the dollar back. They are essentially judges of *credit*, not of *investment*.

In widening their activities via the medium of deposit administration, they are not extending their natural function but deserting it. As millions of former believers have become disenchanted with the illusion of life insurance as an investment and have sought to find true investments elsewhere, the life industry has not gracefully and philosophically accepted the idea that it should be itself and concentrate upon refining its essential product to the end that it may better serve the needs of the people who buy it. Instead, in its pursuit of the dollar, it is straining constantly to take on the form and coloring of an investment. "Protection" has become the tail on the life insurance dog as insurance strives to be all things to all

people. It may be that in the evolution of things financial, the life insurance industry *is* destined to become the sole custodian of the wealth of the nation. As of now, it has demonstrated no skill which would entitle it to anticipate the fulfillment of that dream.

During the last 20 years, the life insurance industry has taken from us $260 billion. It has given us back $89 billion. Heaven help us if it ever gets its hands on the rest of our money.

Chapter 16

Minimum Deposit or Bank Loan Insurance

THE EARLY 1950s saw the development of an innovation in the life insurance field known then as "bank loan" insurance, now more popularly called "minimum deposit" insurance.

The trend to term insurance was cutting into commission earnings of the field forces. The premium for term insurance is low, as we have seen, and most companies further discourage its sale by paying a lower scale of commissions on this type of policy than on cash value insurance. To top it off, the agents are denied credit for term insurance in company sales contests and in qualifying for the Million Dollar Round Table.

Casting about for a way to sell "permanent" cash value insurance at term insurance rates, the agents hit upon bank loan insurance and their home offices cooperated by designing special policies with high first-year cash and loan values.

Approaching a prospect in a high tax bracket, the agent suggested that he purchase one of these special policies calling for a premium of, say, $1000 per year. Pointing out that the policy had a first-year cash and loan value of $700, the agent offered to negotiate a $700 loan with a bank using the insurance policy, when issued, as collateral. The first year's premium was thus paid by a $300 net outlay on the part of the client plus a $700 loan from the bank. The agent represented to the client that this arrangement was cheaper than buying regular term insurance. At the end of the first year, the second $1000 permium is paid by another $300 outlay by the policyholder, plus a new loan of an additional $700 from the bank. This latter is covered by the $700 increase in the loan value of the policy resulting from the payment of the second annual premium. In addition to the $300 net premium, the client pays the bank the interest on the $700 borrowed the first year. One of the claimed advantages of the plan is that the interest paid to the bank on the steadily increasing loan is tax-deductible. To a man in a high tax bracket, this can

be important. His total outlay would be further reduced by any dividend paid on the policy at the end of the first year.

The agent has sold a policy with a premium of $1000—and he is paid a commission of 35% of that premium, or $350. But, you say, the purchaser paid a premium of only $300. Who paid the difference? And again, what about the other expenses of putting the business on the books—underwriting, setting up records, agency expenses, advertising, etc. Who paid those?

The answer is simple, dear reader. You did.

The deficit was charged to surplus, a procedure described in Chapter 10. Surplus is your money, the undistributed profits never paid to you as dividends but instead sequestered in a fund ostensibly accumulated for the greater safety of your policy and its guarantees.

Observe what has happened: the agent has sold a policy which satisfied the buyer's demand for low-cost term insurance, but he has been paid a commission for selling the more expensive "permanent" insurance.

As we know, Section 213 of the New York State insurance laws prohibits a company from paying first-year sales commissions exceeding 55% of the first-year premium. But bank loan insurance established a high premium for the record and permitted the company actually to pay out in commissions more than the new policyholder had paid into it in premiums.

In the low-interest-rate period of the early 1950s, bank loans could be had at very low rates. The banks did not guarantee the rates, however, and as the rates rose by as much as 25% or 35%, purchasers of such plans found that the cost of carrying the policies was greater than they had been led to expect.

Under pressure from the field forces, the companies then brought out the minimum deposit policy, identical with the bank loan policy except that here the company itself agrees contractually to loan the money to the policyholder, making it unnecessary for the agent to negotiate a loan from a bank. The advantage of the minimum deposit policy is that the buyer is assured of his loan at an agreed rate that is not subject to increase.

Agents have sold these policies with the claim that they are cheaper than term insurance. If it costs x dollars to insure a man of 40 for $1000 for one year under a term insurance policy, how can the company sell him the same $1000 worth

of protection any cheaper than that by shuffling its own money around?

The company cannot. The company can accomplish this only by taking money out of the surplus built up by its older policyholders to make up its loss—and that is what it does.

Unfair Discrimination

Some companies have refused to sell minimum deposit insurance despite pressure from the field force for a policy by means of which they can compete with other agents. L. S. Norman, actuary for American United Life, pinpointed the objections of this group: "Minimum deposit insurance is hurting the good name of life insurance. How can there possibly be anything to borrow that has never been paid in or earned on the policy?"

Another company wrote to its agents: "Your company has become increasingly concerned about the long-term social and economic aspects of minimum deposit insurance. We have withdrawn the policy because, in our opinion, it cannot be sold for the long term on a economically sound and socially proper basis."

Spencer L. Kimball and Bartlett A. Jackson observe in *The Regulation of Insurance Marketing*:

> The [minimum deposit] plan is very popular with many agents because it provides a relatively high commission (as high as 90% of the initial cash outlay) for the sale of a plan requiring only a small cash outlay, and with policyholders because of its tax advantages. The plan has allegedly led to misrepresentation, incomplete comparison, misleading advertising and replacement of existing coverage [twisting], and has resulted in numerous complaints to some insurance departments. However, the New York Insurance Superintendent thought that its most unfair aspect was not the agent malpractice to which the plan may give rise, but was inherent in the plan itself. When two policyholders, who at the same age and condition bought essentially similar policies in the same amount from the same company, one a minimum deposit policy and the other a conventional-type policy, surrender them at the end of the first policy year, a return of as much as 70% of the first year premium to one and a return of nothing to the other is inequitable. For this reason, and because of unfair practices the plan

encourages, the New York Superintendent of Insurance has promulgated a regulation that would in effect prohibit the use of minimum deposit insurance.

Let's illustrate all this with an example: John Smith and George Brown each buy a policy from the XYZ Insurance Company. The premium on each is $1000 per year and the policies provide identical amounts of protection. Smith's is a minimum deposit policy, Brown's is not. The agent collects $300 from Smith and this, with the $700 first-year loan value which the company has made available in advance, constitutes payment of the first year's $1000 premium. Out of this, the company pays the agent a commission of $350. (If this had been a term-insurance policy, the agent would have received a $90 commission—30% of the $300 actually paid by the policyholder.) Brown pays the whole $1000 premium out of his own pocket. If the two men die during the first year, nearly identical sums will be paid to their beneficiaries (the $700 loan is deducted from the proceeds of Smith's policy), although Smith had laid out only $300 while Brown paid $1000.

Now, let's suppose both men decide to give up their policies at the end of the first year. Both policies are valueless, Smith's because he had borrowed the whole first-year value, and Brown's because his conventional policy had no first-year cash or loan value. The company made money on Brown—after paying the agent a commission of $440, it had $560 left to credit toward mortality reserves, expenses, etc.

But after paying the agent a $350 commission out of Smith's $300 share of the $1000 premium, the company was in the hole. In addition to the commission deficit, it was out its underwriting costs, the cost of the medical examination, the inspection reports, etc.

The New York State insurance department surveyed minimum deposit insurance and concluded that by granting the relatively high early cash and loan values in comparison with those of other essentially similar policies, an unfair discrimination was created between individuals of the same class and equal expectations of life. Said the department:

> This disparity is due to a disregard of first principles—that cash values between plans must bear a reasonable and regular relation to each other. The relatively high early

cash and loan values on minimum deposit policies, insofar as they result from departures from the regular pattern used for determining the cash and loan values of other essentially similar policies issued, are considered unfairly discriminatory and lend themselves to unsound and inequitable practices. Unfair discrimination exists among policyholders of the same class, namely, holders of policies of essentially the same plan, whenever the terminating policyholder, according to the terms of his policy, is able to obtain a benefit which must be paid for by continuing policyholders in the same class over subsequent years.

Noting that minimum deposit policies permitted companies to evade the intent of Section 213 of the New York insurance laws (which places a limit upon the percentage of the first-year premium which may be paid to agents as commission), the department served notice that henceforth "premium" under the law would mean the amount actually paid in by the policyholder—that is, the net amount paid after giving effect to any policy loan.

Strong Opposition

New York insurance law requires that "no company shall issue any life insurance or annuity contract which shall not appear to be self-supporting on reasonable assumptions as to interest, mortality and expense." This is to say that each policy issued as a plan or a class must be susceptible of actuarial demonstration that it will be financially and actuarially sufficient within itself to produce the necessary premium income to pay the various benefits granted, and do this without resort to the company's surplus at the expense of other policyholders.

Among the industry spokesmen who have questioned minimum deposit insurance was James T. Phillips, vice-president and actuary of New York Life. Said Phillips, in a widely quoted statement:

> The question of the level of guaranteed cash values to be provided by life insurance contracts has always been a matter of considerable management concern. Each company, within statutory limitations, has attempted to provide a liberal scale of cash values to withdrawing policyholders, while at the same time maintaining equity with existing policyholders.

Within this broad concept, there is naturally room for considerable differences in judgment and companies have traditionally, in their normal operations, had different levels of cash values, depending on their objectives, the type of policyholder they were serving, etc.

In recent years, the so-called "Minimum Deposit" concept has placed greater emphasis on the matter of high early cash value policies and a review of the situation as it exists today indicates that this whole matter clearly requires reappraisal.

Take the case of one company's policy which provides a first-year cash value equal to the reserve. For a man age 45, the premium is $34.34 per $1000 and the first-year cash value is $24. But the company pays:

Commissions of 25%, or	$ 8.59
Premium taxes of, say, 2%, or	.69
And the policy's share of the first-year mortality cost on our current experience basis is about	1.68
These items total	10.96
Leaving balance of	23.38

This means that if the company pays the first-year cash value of $24, it is left with less than nothing for expenses—underwriting, setting up of records, agency expenses, and others.

Inherent in these policies with high early cash values we have what, in my opinion, appears to be a departure from the usual concept of what the cash value should be. Theoretically, the cash value should be less than the reserve in the early policy years because, while the company may have enough to meet expenses and the policy's share of mortality costs, it has to draw on surplus to set up the full reserve.

Therefore, in order to protect persisting policyholders, cash values are generally geared to funds on hand so that surrenders normally involve little or no loss. The withdrawing policyholder is usually not given the full reserve as a cash value until the initial expense deficit has been liquidated.

In general, minimum deposit policies do not meet this concept. The policyholders who buy such policies and do

not surrender them in the early policy years, or else the company's general body of policyholders, must take care of the burden created by the losses arising from those who quit without having contributed their share towards expenses. Neither the public buying these minimum deposit policies, nor the agents selling them, are in a position to evaluate the significance of this situation. All they can see is the low initial cost without "counting the cost."

The New York insurance department picked up the cudgel:

> Situations have been brought to our attention which indicate, in certain instances at least, that the sale of such plans may be effected by unsound methods in which the use of borrowed funds to pay premiums and the avoidance of taxes are held out as lures to the prospective policyholder. It has been charged that the plan is frequently marketed without regard to complete comparisons, and in many respects is misrepresented. It is claimed that the plan may be expected to result in high lapse rates in later years.
>
> The sale of high cash value minimum deposit plans to individuals has been productive of numerous complaints to the Department. Additionally, it is manifest from meetings held by the Department with executives of life insurance companies and field force representatives that numerous companies frankly admit the undesirable features of minimum deposit plans but feel compelled to offer such plans to meet the pressure of their agency forces in competition with other companies. Because of these developments the Department has found it in the public interest to explore the effects of this policy.
>
> At the time of the issuance of the high cash value policy, it is generally contemplated that the policyholder will pay in cash only the minimum amount necessary to maintain the insurance. The effect of this type of financing is to give coverage which decreases from year to year due to the increase in the loan indebtedness while the cost of the coverage increases due to the increase in the loan interest. This contract is essentially decreasing term insurance, for the sale of which the company pays the agent a first-year commission which may exceed 90% of the initial cash outlay, whereas Section 213 of the New York Insurance Law

limits the rate of commission to the writing agent to 55% of the first-year premiums on permanent plans and is designed to limit commissions on term plans to a lesser amount.

The one-year term dividend option is designed to keep the insurance coverage at an approximately level amount for some period of years. The option ultimately fails in its purpose because the dividend will become insufficient in the later years to purchase insurance in the full amount of the loan due to the increasing amount of the loan and the increasing mortality cost at the older ages. In the final analysis its purpose is to provide loan insurance, at unspecified rates which are generally lower than CSO net rates.

Generally speaking, the sales illustrations reviewed by the Department do not cover the full period of life expectancy of the prospect but are limited to the first 20 years, contrary to Section 211 of the New York Insurance Law. The failure to extend the illustration beyond 20 years in the case of minimum deposit policies produces a picture which seems unduly attractive and consequently misleading to the prospect. Much explanation for proper understanding is omitted from the illustrations and the result is that the prospect is not generally informed that the maintenance of the maximum loan will ultimately result in a decrease in the insurance coverage accompanied by an increase in cost. In connection with the sale of minimum deposit high cash value policies, the prospect may not be advised that his position would change if his income should decrease so as to put him in a lower tax bracket or if the income tax laws are changed. Such policies have also been sold to people with only moderate or low incomes who would not enjoy the tax advantages mentioned in connection with the sale of the policies. Furthermore, from the nature of the high cash value minimum deposit plan, including the maximum policy loan feature, it is expected that the lapse rates will be high as the policies get older. . . . It is common knowledge in the life insurance business that existing regular policies are being replaced by new high cash value minimum deposit policies to the detriment of policyholders. . . . The replacement has been effected in many instances by withholding information essential to the policyholder to

arrive at a proper decision. The Department considers such methods in the nature of unfair trade practices detrimental to the public interest.

Robert W. Smith, assistant general counsel of Union Mutual Life, in his excellent paper on minimum deposit insurance, concluded:

> It is obvious that without the tax deduction, the policyholder would be better advised to purchase term insurance. Moreover, the tax deduction is a matter of legislative grace, and not every policyholder can be expected to maintain over a long period of years the same relatively high income tax bracket.
>
> Without this [tax] deduction, it seems unlikely that financed insurance plans would have any real purpose or attraction for anyone.

Carl H. Fischer, professor of insurance and actuarial mathematics at the University of Michigan, reported the findings of an actuarial study done on an IBM computer in this unequivocable statement: "If there is no tax advantage, there is never a time when a loan plan is cheaper than term insurance."

Uncertain Tax Advantage

If the only excuse for minimum deposit insurance is the tax deduction on the interest, is there an assurance that those who buy such policies will continue to enjoy the deduction? As Smith said, it is "a matter of legislative grace."

The president of the American Institute of Certified Public Accountants concluded:

> We think that the bank financed insurance plan has been pushed so far that there is now doubt about the validity of the whole thing. Recent tax decisions have indicated that interest on tax-motivated debt may not be deductible. Furthermore, doubt or no doubt, Congress is likely to seal the doom of tax advantage from bank-financed insurance plans.

The noted tax attorney, William J. Casey, in his *Estate Plans,* pointed out that the U.S. Treasury has repeatedly ex-

pressed to Congress its concern over bank loan and minimum deposit insurance and has asked that steps be taken to eliminate the tax exemption on insurance plans involving loans to pay premiums. It is a principle of tax law that a tax advantage may not be achieved by a transaction having no purpose other than to create or obtain such advantage. Concludes Casey:

> If the Treasury's thought were applied, those who have already embarked on a program of so-called bank loan insurance would be caught in the middle. Interest borrowed to pay future premiums would be non-deductible. They would be faced with the unhappy alternatives of either taking a substantial increase in the cost of carrying their program, abandoning the bank loan approach altogether and paying premiums out of savings to cover the transfers, or washing out the insurance and, in many cases, losing additional collateral posted to cover the difference between cash value in the early years, and premium costs to date.

Leonard L. Silverstein, general counsel of the Association for Advanced Underwriting, warned the membership in November 1961 that it should not be lulled into a sense of false security about the administration's attitude toward the income tax deduction for financed life insurance plans which the U.S. Treasury regards as tax loopholes. He cautioned members that the U.S. Treasury people had not given up their efforts but are merely waiting until they get the main tax reform objectives lined up and achieved. Ending the tax benefit on financed life insurance is one of the essential planks in the platform, he said.

The Internal Revenue Service has now made the first move to deal a death blow to the minimum deposit concept. The key point in the IRS position is based on Section 264 of the 1954 Code, which specifies that interest on loans when used to purchase single-premium life policies is not deductible, and that any policy on which substantially all of the premiums are paid in the first four years shall be deemed a single-premium policy. The IRS now contends that at the point where the annual increase in a policy's cash value exceeds the net premium for that year, the policy has been paid for. Hence, if substantially all of the premiums that have been

paid before this crossover point were paid in the first four years of the policy, then the policy is a single-premium policy and not eligible for interest deduction on loans made against it.

Other Uncertainties

There are many aspects of minimum deposit insurance which the layman should study very carefully before he enters into such a contract. For example, if he buys regular term insurance, the policy will contain a disability clause providing for waiver of all premiums if he becomes totally and permanently disabled. If he buys minimum deposit insurance and becomes disabled after having accumulated a substantial indebtedness against the policy through the annual policy loans to defray the premium costs, the policy's disability clause may take care of the premiums on the policy, but it will not take care of the substantial interest obligation which he must pay each and every year.

Most minimum deposit insurance proposals lean heavily upon projections of dividends at the current scale. A review of Chapter 21 will confirm that such projections should be distrusted. In keeping with the general slackening of the industry's standards of honesty and fair practice, the sales talk does not clearly establish that dividends are neither guarantees nor estimates but are, as Halsey D. Josephson, general agent in New York for Connecticut Mutual Life, characterized it, compiled "on the basis of nothing more than fantasy." At the end of this chapter is a typical example of a proposal for minimum deposit insurance. You will observe that while a column headed *Annual Dividend* appears, there is absolutely nothing anywhere in the proposal to suggest that the dividend is not assured.

Let us wind up this brief discussion of minimum deposit insurance by summarizing the hazards:

1. It assumes that a person will be in a high income tax bracket for a long period of time.
2. It assumes that the present tax deduction will continue indefinitely.
3. It is based upon a dividend projection which is untrustworthy, since dividends projected during these high-yield years may be reduced substantially in future years.
4. The cost of the plan becomes excessive in the later years.

TABLE 10

John S.
Policy No.

MINIMUM DEPOSIT PLAN

Premium	$1,108.25
Waiver of Prem.	65.00
Double Indemnity	31.50
Total	$1,204.75

Year	*Age*	*Gross Premium Plus Interest*	*Loan Available*	*Annual Dividend*	*Cost of Term Insurance*	*Required Outlay*	*Total Loan*	*Interest on Loan @ 5%*	*Amt. of Term Insurance*	*Death Benefit*
July 1961	53	680	434			245	435			24,565
Oct. 1961	53	1,210	709	89	14	426	1,144	6	1,201	25,075
1962	54	1,263	710	99	24	478	1,853	57	1,946	25,093
1963	55	1,298	710	109	36	515	2,564	93	2,692	25,128
1964	56	1,334	710	118	51	557	3,273	128	3,437	25,164
1965	57	1,369	709	127	68	601	3,982	164	4,181	25,199
1966	58	1,404	707	137	87	648	4,689	199	4,923	25,234
1967	59	1,440	659	148	109	742	5,348	235	5,616	25,268
1968	60	1,408	654	161	134	727	6,002	268	6,302	25,300
1969	61	1,440	648	177	163	777	6,650	300	6,983	25,333
1970	62	1,473	641	195	195	831	7,292	333	7,656	25,364
1971	63	1,505	634	215	215	871	7,926	365	7,760	25,166
1972	64	1,537	626	237	237	911	8,551	396	7,863	24,312
1973	65	1,568	617	260	260	951	9,168	428	7,985	23,817
1974	66	1,599	607	283	283	992	9,775	459	8,012	23,237
1975	67	1,629	597	301	301	1,033	10,371	489	7,875	22,504
1976	68	1,659	586	319	319	1,073	10,957	519	7,709	21,752
1977	69	1,688	573	335	335	1,115	11,530	548	7,455	20,925
1978	70	1,685	561	349	349	1,123	12,091	577	7,150	20,059
1979	71	1,713	548	361	362	1,165	12,639	605	6,805	19,166

Chapter 17

Funding

A CURIOUS reverse twist has been given to the process of borrowing money on life insurance policies to invest in mutual funds.

The concept, known as "equity funding," "secured funding," or "life funding," proposes that you borrow on your mutual fund shares to buy life insurance. Several companies have been formed to promote the scheme.

This is the way it works:

The investment dealer suggests that you embark upon a program of annual investment of, say, $2000 in mutual fund shares. He takes your order for the shares and your check and pays the fund, which then delivers your shares direct to one of the funding companies. The funding company processes your application for an ordinary life insurance policy on your life at a premium of $1000 annually, and puts up your $2000 worth of mutual fund shares with a bank as collateral for a $1000 loan which is used to pay the first year's insurance premium. A degree of leverage is thus introduced into your estate plan—you own $2000 worth of mutual fund shares and perhaps a $30,000 life insurance policy. Next year, the process is repeated; you invest $2000 and borrow $1000 against it to pay the second annual premium on the life insurance policy.

Now I have nothing against the idea of introducing leverage into estate planning, but this is simply a scheme to sell cash value insurance. The promoters of the plan will not accept your application for term insurance with its low premium rates and low commission schedule. The promoters are life insurance general agents and their whole purpose is to sell "permanent" life insurance.

Douglas Thornsjo, in an article in the October 1962 issue of *Best's Life News*, discussed the motives of the insurance men who combine life insurance and mutual funds: "If insurance sales are the objective, the simple, time-honored, whole life policy makes the best companion with funds."

Well, since I don't suppose that insurance sales are *your*

objective, there seems little point in your becoming involved in this arrangement.

It may well be a smart idea to borrow on mutual fund shares to buy *protection*. But to borrow from a bank at 5% interest and invest the proceeds of the loan in a life insurance policy paying 2½% on what is left of the money after the very considerable costs of selling you the policy? That's preposterous.

The Securities and Exchange Commission has thrown a small monkey wrench into the program, which depends for its operation upon the active support of mutual fund dealers. The SEC ruled that no investment broker or dealer could directly or indirectly extend or maintain, or arrange for the extension or maintenance of, credit to or for a customer. The rule was intended originally to prevent investment dealers from extending or obtaining credit for customers so that they could buy mutual fund shares or other securities. The SEC ruled that the purpose of the loan is not a significant factor; the act of borrowing was what it sought to control.

It is difficult to understand how the SEC could construe its mission and authority to encompass the right to deny a mutual fund salesman the privilege of assisting a customer in securing a loan on his mutual fund shares to pay the premiums on an insurance policy. To this extent, I'm on the side of the funding people. They got busy and retained an experienced professor of law at a leading university as a consultant. In no time at all, he came up with some arguments sufficiently cogent to cause the SEC to change its mind so far as certain categories of mutual fund salesmen are concerned.

The question here is not who should sell this plan, but rather who should buy it. The answer is: No one. Wrap cash value life insurance up in a thousand gimmicks and it's still cash value insurance—something to be avoided.

The SEC has now ruled that the funding "package" constitutes a separate security offering in and of itself, and the promoters must therefore give prospective buyers a prospectus setting forth the material facts relating to the offering. They must also show that the plan is "suitable" for the client.

Some of the hazards attending participation in the program may be gleaned from the prospectus put out by one of the principal firms in the field in connection with its sale of a stock issue to raise money to finance its operations. The prospectus states:

The premium payment loans are on a demand or short term basis and either Equity Funding Corp. or the customer may terminate a loan or the loan program at any time. If the value of the collateral should at any time decline to an aggregate value at which the lender feels itself insecure, it may demand the deposit of additional collateral or repayment of the loan balance. Repayment may be demanded even in the absence of a decline in the market value of the pledged shares.

If repayment is not forthcoming, the lender may sell the collateral to recoup loans and accrued interest and any excess will be remitted to the customer. Neither the customer nor Equity Funding Corp. is under any obligation to continue the loan program in connection with any future program payments.

Chapter 18

Net Cost

LIFE INSURANCE men are given to quoting something called "net cost." Invariably it is illustrated over a 20-year period and is arrived at by adding up all the premiums you would pay during the 20 years, deducting the dividends (if any) which would be refunded to you, and then deducting the cash value of the policy after 20 full years. The resulting figure is represented to be the net cost of owning the protection.

Net cost thus figured supports the shaky principle that the higher the premium cost, the larger the cash value created. By subtracting the high cash value from the high premiums paid, your cost for the insurance element appears small. Actually, there are two possible costs. The insurance agent shows you the net cost *if you live*—but he does not show you the net cost if you die and so forfeit your cash value, having paid far higher premiums during the years prior to your death. In that case, your net cost is a far different matter.

Net cost is illusory, for the "profit" which produces the low net cost remains in the policy and is surrendered at death. The alternative, if you hold to the co-insurance theory, is that the profit is used by the company to reduce its risk. The only way you can achieve the low net cost projected by the agent is by canceling the insurance and losing the protection. Since it is unlikely that the best time for you to do this will be in exactly 20 years, the figure the agent displays to you as representative of the net cost in precisely 20 years is largely meaningless.

The argument based on net cost is therefore misleading if not dishonest. In the first place, the agent shows you a 20-year cash value. But the records disclose that few people keep insurance 20 years; the average policy life is 7 years. Chances are that there will be no cash value at all in the policy after one year, and darned little after 2 years. Showing a man the net cost to him after he has held a policy 20 years, when the odds are very high that he won't hold the policy that long, is questionable sales practice.

Another joker in the net cost deck involves the surrender charge levied by all companies against withdrawing policy-

holders. You'll remember that the reserve of each policy consists of premiums paid in advance under the level-premium system, plus the accumulating savings account you purchased in conjunction with the reducing term insurance which is the protection part of your policy. By any reasonable standard of honesty, the policy reserve belongs to you—it's your advance premiums and your savings account—and if you decide to call the whole thing off, you'd expect the company to return the reserve to you. The company won't do it, though, if you have held the policy less than a full 20 years. If called upon to pay the reserve to you, it will deduct a "surrender charge." The company claims that it is losing money on the policy because you gave it up, and wants you to make good its loss. The surrender charge is not spelled out in so many words. The policy just shows a cash value less than the true reserve on the policy.

When they illustrate net cost, agents always show the cash value at the end of the twentieth year, *when the surrender charge has just dropped off*. The cash surrender value in the years just prior to the twentieth are not in proportion, and therefore the net cost is proportionately much higher in those years.

A third deceptive factor in net cost illustrations is the dividend projection. Such illustrations assume the continuance of dividends at the current scale. As we shall shortly see in Chapter 19, these projections are a mirage. There is every likelihood that the estimates will not be fulfilled. Even some of the agents themselves are branding as fakes the companies' figures on dividends they expect to pay.

The impression given by net cost illustrations is a distorted one, then, and yet it is that very impression which leads many sensible people who started out to buy term insurance to change their minds and switch to high-cost cash value insurance. Given an honest and fair presentation of the facts of net cost, they wouldn't touch the cash value policy with a ten-foot pole.

After a year or two or five, they do find out about it and they give up the policy. But meanwhile the agent got his big commission and the company's net loss for putting the business on the books was charged off to surplus. The policyholder then goes out and starts buying insurance all over again, and another agent pockets another commission.

In its agent-training material, Phoenix Mutual has advised its field men: "Stress the unique service of the Phoenix Mutual

and emphasize the fact if he has reference to 'net cost' that it can never be anything but an estimate."

How Computed

Let's examine the way net cost is arrived at.

Assume that you have a policy into which you have paid premiums totaling $600 during the past 20 years. Your dividends in that period totaled $100. The policy has a present cash value of $500. The insurance man will point out happily that the insurance has cost you nothing—you can get back every cent you paid in.

This misrepresentation is based upon the insurance man's complete disregard of the interest factor. You have had one other item of cost which he has failed to mention—the interest your premium money would have earned if it had been deposited or invested elsewhere. By ignoring this factor, the agent can, in the case of some endowment and limited payment life policies, make it appear that you are actually getting back from the insurance policy more than you put into it.

The insurance buyer may swallow this hook, line, and sinker, failing to realize that the insurance company cannot give you something for nothing, regardless of the juggling of figures by the agent. Let's take a $1000 nonparticipating 20-year endowment as an example. The annual premium at age 30 is $43.12; at the end of 20 years the purchaser will have paid in a total of $862.40. The policy matures for $1000 and it therefore appears that he has a profit of $137.60 on his "investment."

If, instead of buying the policy, he had invested the $43.12 premium each year at 3¾% interest, he would now have $1251.21. Since the insurance policy pays him only $1000, it is obvious that instead of having a profit of $137.60, he actually has a net cost of $251.21. The way the insurance man explained it, *the company was giving* the policyholder $137.60. In actual fact, *he was paying the company* $251.21 for protection over those 20 years.

Any net cost figure which does not take into account the interest that the premiums would have earned elsewhere is fictitious. It assumes that the buyer's premium payments are of no value to him and will not earn anything if placed elsewhere. This is incorrect, because he could easily obtain 3¾% or more in U.S. savings bonds or in a savings bank. Insurance companies average more than that on the funds they invest.

Still another error in the insurance man's net cost figures is the assumption that the net amount of insurance in force has remained the same throughout the 20-year period. In our examination of the operation of cash value life insurance in an earlier chapter, we observed that the insurance in force is reducing constantly as the cash value is building up. In computing the 20-year cost per $1000, the agents—and the companies—use the face amount of the policy instead of the *average* amount of *actual protection* provided by the policy.

There is only one correct way to compute the cost of insurance and anyone, with the help of the 3¾% compound interest table appended to this chapter, can quickly and easily figure this cost for himself. In nonparticipating policies only four factors are involved: premium, interest on premiums, cash value, and average net insurance in force.

EXAMPLE: $10,000 Ordinary Life Policy
Premium: $180 Period: 35 years (age 30 to age 65)

Incorrect Method		*Correct Method*	
35 premiums, $180 each	$ 6,300.00	35 premiums invested regularly over 35 years @ 3¾% int.	$12,710.98
Guaranteed cash value	5,800.00	Guaranteed cash value	5,800.00
35 years cost	$ 500.00	35 years cost	$ 6,910.98
Average yearly cost	14.28	Average yearly cost	197.45
Average net insurance	$10,000.00	Average net insurance	$ 7,100.00
Average cost per year per $1000	$ 1.43	Average cost per year per $1000	$ 27.80

EXAMPLE: $10,000 20-Year Endowment
Premium: $472.10 Period: 20 years (age 35 to age 55)

Incorrect Method		*Correct Method*	
20 premiums, $472.10 each	$ 9,442.00	20 premiums invested regularly over 20 years @ 3¾% int.	$13,698.00
Guaranteed cash value	10,000.00	Guaranteed cash value	10,000.00
20-year gain	$ 558.00	20-year cost	$ 3,698.00
Average yearly gain	27.90	Average yearly cost	184.90
Average net insurance	$10,000.00	Average net insurance	$ 5,000.00
Average gain per year per $1000	$ 2.79	Average cost per year per $1000	$ 36.98

To determine the actual future value the money you pay for premiums would have if invested elsewhere at 3¾%, simply multiply the annual premium by the factor shown in Table 11.

TABLE 11

Number of years premium is to be paid	*Factor*	*Number of years premium is to be paid*	*Factor*
1	1.000	38	81.356
2	2.037	39	85.407
3	3.113	40	89.610
4	4.230	41	93.970
5	5.389	42	98.494
6	6.591	43	103.187
7	7,838	44	108.057
8	9.132	45	113.109
9	10.475	46	118.351
10	11.867	47	123.789
11	13.312	48	129.431
12	14.812	49	135.285
13	16.367	50	141.358
14	17.981	51	147.659
15	19.655	52	154.196
16	21.392	53	160.978
17	23.194	54	168.015
18	25.064	55	175.316
19	27.004	56	182.890
20	29.017	57	190.748
21	31.105	58	198.902
22	33.271	59	207.360
23	35.519	60	216.136
24	37.851	61	225.242
25	40.271	62	234.688
26	42.781	63	244.489
27	45.385	64	254.657
28	48.087	65	265.307
29	50.890	66	276.152
30	53.799	67	287.508
31	56.816	68	299.290
32	59.947	69	324.195
33	63.195	70	337.352
34	66.565	71	351.003
35	70.061	72	365.165
36	73.688	73	379.859
37	77.452	74	395.104

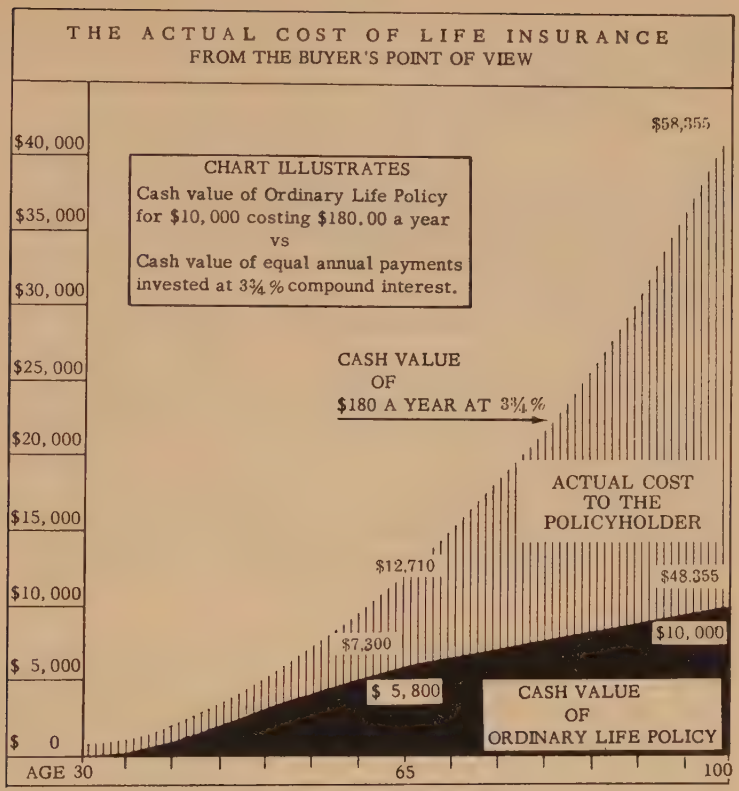
If you have a limited payment life policy upon which premiums are not paid over the entire lifetime of the policy and

want to know what that money would amount to if put in a savings bank, use Table 11 to compute the investment value of the premium money during the years you are paying premiums. Then use Table 12 to determine the increases after you stop adding to the investment by multiplying that figure by the appropriate factor in the table:

TABLE 12

Number of years funds remain on deposit after completion of premium paying period	*Factor*	*Number of years funds remain on deposit after completion of premium paying period*	*Factor*
1	1.037	29	2.908
2	1.076	30	3.017
3	1.116	31	3.130
4	1.158	32	3.248
5	1.202	33	3.369
6	1.247	34	3.496
7	1.293	35	3.627
8	1.342	36	3.763
9	1.392	37	3.904
10	1.445	38	4.050
11	1.499	39	4.202
12	1.555	40	4.360
13	1.613	41	4.523
14	1.674	42	4.693
15	1.737	43	4.869
16	1.737	44	5.052
17	1.869	45	5.241
18	1.939	46	5.438
19	2.012	47	5.642
20	2.088	48	5.853
21	2.166	49	6.073
22	2.247	50	6.300
23	2.331	51	6.537
24	2.419	52	6.782
25	2.510	53	7.036
26	2.604	54	7.300
27	2.701	55	7.574
28	2.803		

CHART 7



From the buyer's point of view, the actual cost of life insurance at any time is the difference between the cash value of the policy and the cash value of equal payments invested and accumulated elsewhere.

The striped section in the chart illustrates this difference and how it increases at an accelerating rate as the policy grows older. In the above example, the *actual cost to the policyholder* is: AT AGE 65—$7,300. AT AGE 100—$48,355.

In the meantime the net insurance protection has reduced from $10,000 at age 30 to $4200 at age 65 and to zero at age 100 when the policy matures.

The comparison is based on 3¾% interest as this rate is available to everyone—from U.S. Savings Bonds and insured deposits—and is less than the rate currently earned by insurance companies.

Chapter 19

Obsolescence

WHILE LIFE insurance comes in an infinite variety of sizes and shapes, there are those who claim that it has not kept pace with the times, has not developed to meet changing needs. Consider the view of Robert I. Mehr, professor of insurance at the University of Illinois:

> It would be possible to examine the entire list of policies issued by most American life insurance companies today and show that each is but an adaptation or variation of one of the plans available in 1762.

Here are some highlights from Mehr's address to the American Risk and Insurance Association (formerly the American Association of University Teachers of Insurance), as reported in the *National Underwriter*:

> Over the past 200 years the uses of life insurance have expanded from providing simple burial funds to a variety of uses in the economy, yet life companies are still trying to meet these new needs with policy forms essentially two centuries old. . . .
>
> Mr. Mehr, a speaker on the panel, "Has the Life Insurance Company Product Become Obsolete?," said that it seems justifiable to say that life companies have not been alert to the need for new policy forms but have been dealing only in old forms with new twists and adaptations.
>
> Two of the basic uses for which life insurance is sold are death benefits and retirement income—the first an insurance function and the second a simple savings and investment use. . . .
>
> The procedure of using permanent life contracts to insure income in case of death and to provide a retirement income if the insured survives his productive years appears to be torturing a policy form into a use for which it was never intended—torturing a premature death protection form into a retirement annuity. . . .

"It seems illogical [Mr. Mehr said] to cover transitory needs with permanent insurance while leaving a major permanent need to be covered only as a by-product of these transitory needs. It means a misuse of premium dollars since inevitably if a man lives, he comes to the day when he is spending money for amounts of premature death protection no longer necessary. The dollars used to purchase superfluous death protection could be used to build a more adequate retirement program. How much easier might the task be of building a reasonable retirement income if the insurance were reduced each year, retaining only that amount needed to provide a given level of income to the widow and releasing death protection premium to build a retirement annuity. . . ."

Obsolescence in the life insurance product, Mr. Mehr said, comes in expressing benefit payments in a fixed number of dollars, the value of which may be expected to decline over the period of the contract because of inflation. . . . [Benefits] might well be expressed in fixed purchasing power units rather than fixed dollars. The premiums, of course, would have to be adjusted accordingly at each premium date.

Note, first, Mehr's acknowledgment that cash value insurance has two functions, "the first an insurance function and the second a simple savings and investment use." Crystallized in this statement is the essence of my contention that life insurance companies are today insisting upon performing a function for which they were never intended and for which they are not equipped.

The crux of it all is that "simple savings and investment use." Savings is a banking function. Savings banks and similar institutions exist to perform that function. The life insurance companies have always bitterly opposed the sale of insurance by the savings banks of Massachusetts, New York, and Connecticut on the grounds that insurance is not the function of banks. Yet the insurance companies have blandly insisted upon the right to carry on a banking function through the medium of cash value insurance.

As for the "investment" part of Mehr's statement, the sale of investments is rigidly controlled in this country by the various Securities Acts as well as by the rules and regulations of the exchanges and of the quasi-governmental associations to

which investment dealers are obliged to belong. The kind of securities which may be sold, the manner in which they may be offered, and the people who may sell them are all regulated.

There is no such regulation of the insurance product. Who ever heard of a life insurance man giving a prospectus to a customer? When the Supreme Court upheld the ruling of the Securities and Exchange Commission that the variable annuity had to be sold under SEC supervision and with a prospectus, the president of the second largest life insurance company in the world threw up his hands and said that if the variable annuity had to be sold with a prospectus, his company would abandon the whole idea.

The insurance industry undertakes to perform a banking function but it does not wish to provide the assurance of liquidity a bank must provide. It insists that its product be regarded as a properly constituted investment while refusing to submit itself to regulation as an investment dealer.

Mehr observes that the procedure of using permanent life contracts—cash value insurance—to provide both protection against the economic loss occasioned by death *and* a retirement income "appears to be torturing a policy form into a use for which it was never intended." This statement came from a man who teaches life insurance, who is truly an expert on what it will do and will not do. The statement was made to a meeting of other experts like himself. These are not the men who sell life insurance, and you could search the land from coast to coast and I don't think you would ever find a man who *sells* life insurance agreeing with this view.

Purpose of Life Insurance

I has always contended that life insurance was intended to provide an estate if you don't live long enough to accumulate one yourself. The amount of insurance in force, therefore, should always be the difference between what you have accumulated to date and the total amount you expect to accumulate by retirement age. The ideal estate plan, then, is one which provides for reducing term insurance supplemented by a separate savings and investment program. Life insurance salesmen denounce this as heresy. Life insurance should be level and permanent, they claim. By permanent, they mean it should run until you are 100 years old. A moment later, they are reminding you that when you are 65 and the kids are all

on their own and your principal interest is in a retirement income, you can cash in that "permanent" insurance and live on the annuity income it will provide.

Of course, inflation has made the annuity a deadly trap for many a lifetime saver. Mehr suggests that the problem be solved by having a variable annuity such as the insurance companies have been struggling to bring out. He suggests that the income should be fixed in purchasing power rather than in dollars alone. This idea is not new. In a number of European countries certain government bonds are payable in variable amounts tied to the price of a dozen eggs or a 100-kilometer railroad ticket. In 1954, Professor Sumner Slichter, the late distinguished Harvard economist, proposed that our own government cease issuing the prevailing type of savings bond and bring out instead a bond payable in a fixed degree of purchasing power rather than in fixed dollars. He complained that the government was taking advantage of the people with the type of bond it was then (and is still) offering.

There is no question but that Mehr is on the right track. Our only disagreement is over whether the life insurance industry is the one to handle a program for accumulating funds for retirement, a noninsurance function.

Innovations Needed

Another viewpoint on the question of the obsolescence of life insurance was expressed by Robert W. Osler, president of the National Underwriters Insurance Company, in an address to the same American Risk and Insurance Association. Said Osler, in part:

> . . . today's policies fall far short in many respects of being well-adapted to what the buyer needs and wants. [They] provide talking points for the agents, and they are easy to issue and service; but the designers of them often seem as unfamiliar with human needs as today's car designers are with the human anatomy.

Reported the *National Underwriter:*

> Mr. Osler decried what he called "the old actuarial cover-up, 'anti-selection,' " and twitted the companies on their un-

willingness to make newly designed benefits available to old policyholders, calling it "a glaring example of obsolescence."

"So far as I have ever been able to ascertain, no life company has ever based its product design on a really objective survey of what its market would like to have in life insurance policies."

Here we've seen two experts testifying that life insurance is obsolescent. The companies have dolled the old girl up and given her plenty of rouge in a determined effort to make her look like a young chicken again. They can call it the "President's Protective Investment Plan" or any one of a thousand other high-sounding titles, but it's still just that same, good-natured old financial slob—20-payment life.

Chapter 20

Inflation

IN GERMANY BETWEEN the world wars, a man died. His family made application for payment of the life insurance for which he had paid premiums nearly all his life. Those premiums had been hard to meet at times but he had never begrudged them, for they would give his family financial security when he was gone.

When the money came from the insurance company, it was just enough to pay for the wreath hung on his door. Some people didn't even bother filing claims under insurance policies carried by the family head; the stamp to mail in the claim papers would have cost more than they'd get back.

Inflation had made life insurance almost worthless.

Life insurance in America pays off in dollars—and dollars are a bad investment. The American dollar has been going down since the first one was coined. Some people think that inflation is a postwar phenomenon or peculiar to our country, or to our times.

Inflation has gone on for all recorded time. It is a natural law, like gravity. Arnold Toynbee reports that he has never studied a civilization whose money didn't eventually peter out. Historically, money is a bad investment. Anything which guarantees you a fixed number of dollars in the distant future guarantees you a loss.

Everything material in this world fluctuates in value. In some things—securities, real estate, commodities—the fluctuation is measured in dollars. In others—savings bank accounts, postal savings, savings and loan accounts, savings bonds, life insurance cash values—the fluctuation is measured in terms of purchasing power.

Which do you want to preserve, dollars or purchasing power? You can't eat the dollars; you must exchange them for goods or services. Over the years, the dollars buy fewer and fewer pounds of butter and pork chops. For the long haul, then, it's a good idea not to hoard dollars.

There are interruptions in the long-term upward trend of

all prices. The longest and the worst such interruption in this century was that of the early 1930s. For two and a half years, prices went down. Then they started back up. July 1932 was the low mark in the securities market. Investment losses were the order of the day. Actually, a man who'd had $100,000 in 1929 and had only $50,000 of it left in 1932 hadn't lost a thing; he could buy more with the $50,000 than he could have bought in 1929 with the $100,000. Security prices have sometimes gone contrary to the cost of living, but generally—as investments reflected major declines in security prices—the cost of living has moved down, too.

Germany had printing-press inflation. France, on the other hand, had a controlled inflation; since World War I, the franc has shrunk to 1/84th of its former value. We are having controlled inflation in this country. Let us consider what it will mean to us if we have the same degree of inflation the French have had. The price of the average medium-priced car will climb to $250,000. One hundred dollars will buy enough meat for a meal for two adults—or one large dog. If you leave your wife $100,000 worth of life insurance, it will provide her with room and board for one year.

Now, I can hear you saying, "It can't happen here."

Disabuse yourself. It *is* happening here.

I can show you a page from *The New York Times* of 25 years ago containing an advertisement for a new Chevrolet. The price—$495. If you go to buy a car now, the *extras* will probably cost you close to $495!

If we have the same degree of inflation over the next 25 years, that same Chevrolet is going to cost $8900. You're probably planning to be around at that time. Are you planning to drive an $8900 Chevrolet? Are you planning to have the $8900 to pay for it? You'll need a car, you know, to get to the store so you can buy some pork chops at $6.25 a pound. If you're living on meager Social Security income, you may have to be satisfied with the cheapest grade of hamburger—that'll be only $3.50 a pound.

I don't know that I've ever seen a figure of how much money was lost in the stock-market crash of 1929. I'm sure that it was a breathtaking total.

I do have another figure, though, which is more significant to all of us right now. In various savings media—savings accounts, time deposits, savings bonds, Social Security trust funds, annuities paid out and life insurance in force—the

American people have had average holdings over the last 25 years totaling $401.8 billion. On this, they have suffered a 58% loss in purchasing power, or $233 billion. This *actual* loss dwarfs the *paper* loss in 1929.

In the years from 1921 through the climactic year 1933, Americans lost $1.1 billion in bank failures. The purchasing power loss on the dollars they've hoarded in the years since is *213 times* the loss in bank deposits!

On their life insurance holdings alone, Americans have lost $148.1 billion in purchasing power over the past 25 years.

Where does this leave that savings account you've been building up as a part of your life insurance policy? In the face of this relentless melting away of the real value of the dollar, how safe is a savings account with an insurance company which is going to be paid in 20 years or when you're 65 or 100 years of age? Have you taken into account the most deadly weakness of life insurance—its vulnerability to inflation?

Thousands of old people have had to go back to work because the "guaranteed income" from their insurance was no longer sufficient to pay their living expenses. The insurance companies who once advertised a policy providing a retirement income of $100 per month now offer one providing $300 per month. The trusting souls who paid in their hard-earned 1930–1950 dollars to get that $100-a-month income are now being paid off in dollars of much-reduced purchasing power.

In an article, "Sound Money And The Voter," in the February, 1962, issue of *The Financial Analysts Journal,* Edward B. Hall offered these observations upon the attitude of life insurance men toward the question of inflation:

> The inflation of the past 20 years has not been a discouragement to the growth of life insurance and pensions—quite the contrary. It has been a boon and a stimulus to the army of salesmen. "You know," they say, "what it costs to live these days, and to educate children. You need more insurance." Modern technique is to emphasize estate planning and family planning and to present neatly typed and bound programs, setting forth certain numbers of dollars for retirement income, education, and grocery money in case of death of the breadwinner. If you try to defend your pocketbook against the pressure by suggesting that

maybe when the boy is ready for college, the amount suggested may not pay his bus fare, it makes the insurance man furious. He knows he cannot give any assurances, and doesn't want to think about the problem—much less talk about it.

It is not surprising, therefore, that the life companies have put out only a little gentle propaganda in defense of a sound dollar. . . . Assurance of a fixed number of dollars at some future time is still described as "safety."

Many years ago, the Carnegie Foundation for the Advancement of Teaching created the Teachers Insurance and Annuity Association to function on a nonprofit basis and provide retirement benefits for staff personnel in colleges, universities, independent schools, foundations, and certain other qualifying nonprofit institutions. But in 1951, the TIAA reached this conclusion:

Security in retirement poses a difficult problem when it means not only a sufficient annuity income in dollars, but also a reasonable income in current purchasing power. Traditional methods of saving have been effective in providing the dollar income; they have fallen short of the goal of providing suitable purchasing power income.

As a result, the College Retirement Equities Fund was organized in 1952 to supplement the existing traditional annuity program. Its purpose: to give teachers a chance to protect their surplus dollars from inflation through participation in a broad list of securities. Said the Foundation:

Business activity has its ups and downs—the investor in common stocks must expect them—but in the long run an accumulating share in the growth and earnings of the major American industries seems a good way to assure a healthy retirement income, much as industrial growth helps assure the economic well-being of the nation as a whole.

Publicly, the life insurance industry has refused to acknowledge the impact of inflation on its product. It has insisted that Americans go on hoarding dollars in its long-term savings plans which are at the mercy of inflation.

While Kenneth M. Wright was reporting in the May 1960 issue of the *Journal of Finance* that "a strong shift has taken place in the 'product mix' of life insurance toward term insurance and away from plans with a substantial savings element, apparently stemming from public fears of inflation and a consequent reluctance to save through long term, fixed-dollar contracts," John Barker, Jr., vice-president of New England Life, was quoted in the *National Underwriter* (January 13, 1962) as saying: "Life insurance is impervious to depreciation. A life insurance policy resembles more closely a bottle of fine brandy which becomes, at least to the palate of one able to appreciate it, finer and more satisfying with the passage of the seasons."

Barker seems to have gotten his life insurance and his brandy mixed. In the last 25 years, life insurance policyholders have lost $148 billion in depreciation of the purchasing power of their policies—and Barker says life insurance is impervious to depreciation. He must have had too much "insurance" when he made that effusive speech!

M. Albert Linton, former president of one of the largest life companies and author of a fragile piece entitled "Life Insurance as an Investment," wrote:

> Another advantage of the life insurance investment is that you know just what its value will be in the future. In the case of a separate fund invested in stocks, bonds or mutual funds, you do not know. Death may occur or a serious emergency may arise, and the amount the separate fund would realize could be embarrassingly low. That was indeed the case in countless instances in the 1930's.

(There he goes, rattling the old bones of the '29 crash again. No mention of the moratorium on the payment of insurance cash values, though, or the artificial convention values which kept the insurance industry from going into bankruptcy in 1933.)

> Of course, the reverse may be true. The value of the separate fund may be high. One has to balance that possibility against the possibility of a low value and its consequences, and then reflect upon the guaranteed features of the life insurance policy.

The Inflation Gamble

Do you get the impression that one financial program offers a 50–50 chance of profit or loss, while the other (insurance) offers no possibility of loss, simply a guarantee of profit? Well, that's the way the insurance men talk to *us* about insurance as an investment.

When they get together with each other, it's a vastly different story. Walter G. Bowerman, assistant actuary of New York Life, wrote a frank article titled "Purchasing Power Policies" for an insurance magazine, *The Spectator*. Here are some excerpts:

> The high rates of surrender under endowment policies at the later years of duration have been due in large part to inflation. . . . After studying the curve of purchasing power since 1800, we find it hard to see how any marked increase can be expected for years to come.
>
> If we are willing to face the truth for ourselves, we must admit privately that life insurance and pension funds as now issued are something of a gamble insofar as the proceeds have any definite forseeable purchasing power.
>
> A deliberate governmental policy of continued slow inflation in perpetuity at from 3 per cent to 8 per cent per year is new. It has already played hob with cash value insurance.
>
> Term insurance is now about 30% of all the life coverage in U.S. companies. This is a vast increase compared to a decade earlier. The amount and proportion are both on the increase, like a snowball rolling down hill! This movement away from the investment element in life insurance is another reflection of the problem of inflation.

Sherwin C. Badger, financial vice-president of New England Life, warned: "The business had better get busy and investigate ways of gearing life insurance and annuity incomes to changes in the purchasing power of the dollar."

Robert A. Rennie, vice-president of Nationwide, said in a speech: "People want inflation insurance."

In an address to the Society of Actuaries, L. J. McDiarmid, vice-president of Lincoln National Life, offered an interesting commentary on insurance and inflation. Here are some excerpts (italics added):

If the life insurance industry is to continue to fully perform in the future the role which it has performed in the past, then some attempt to merge life contingencies with equity investments, and to depend less exclusively on fixed currency investment media, seems in order. *The alternative would be for the business to become increasingly a provider of term insurance*, with its savings aspects which have been very important in the past and very beneficial to our economy as a whole tending to decline in importance, both relatively and absolutely. . . .

In the case of life insurance other than term there is a substantial lapse of time on average between receipt of premiums and payment of claims. . . . For example, in the case of a 20-payment life contract issued at age 30, a period of about 29 years would elapse between payment of premiums and receipt of benefits. . . . Such a period is certainly long enough for inflation, even operating at the modest rate of 2% per annum to reduce the value of a currency unit by 44%. In the case of an ordinary life policy issued at the same age, the corresponding time lapse of about 17 years can be highly significant if it occurs over a period such as 1940–57.

In the case of endowment policies, the average time between payment of premiums and receipt of benefits does not tend to be as long as for the whole life plans. However, since the former are predominantly savings plans, the effect of inflation on their future value tends to be magnified. On the other hand, *term plans show a rather short average time lapse from payment of premiums to receipt of benefits, and the eroding effect of inflation is correspondingly minimized.*

There is widespread feeling that further loss in money value is a very strong possibility, and in the opinion of many students of the subject, a probability. . . . In view of the rising trend of dollar incomes and savings of individuals . . . it seems that *life insurance has tended to become a less favored medium for the accumulation of savings than formerly.*

A broad field for equity investment no doubt exists in common stocks or shares. While these are by no means a perfect hedge against inflation . . . they are probably the best large-scale medium available for this purpose.

Equity investments, and most particularly, common

stocks, might be introduced more widely into the structure of life insurance.

A [policy] reserve intelligently invested in equities over a [20-year] period will tend to represent a larger dollar accumulation at the end of the period than a fixed dollar reserve.

It appears that over an extended period of years, *common stocks which are selected with an average amount of skill and good fortune are a more efficient accumulator of dollars than fixed-dollar investments which yield 3½% on average.* Over a 20-year period, this has been almost universally the same. It would be possible to pick a 20-year period in the past when this was not true, but such a period would have to end in the depression years 1932, 1933 or 1934, which were very exceptional years in our economic history. It is unlikely that such a period will be repeated. Even over shorter accumulation periods than 20 years, the comparison has in general been favorable to common stocks.

It is not necessary to seek out a period which ends with stocks at a relatively high level to make such accumulations turn out superior to fixed-dollar accumulations.

One reason for the satisfactory behavior of common stock accumulations, even in the face of market conditions which at first glance would seem to mitigate against the process, is the beneficial effect of dollar [cost] averaging. As a result of this, fewer shares are bought in such years as 1929, 1936 or 1957, when stocks attained peak levels, and a larger number of shares would be purchased in periods when stocks were at relatively low levels. The average cost per share, therefore, tends to be below the average level of the market.

It is probably a fact that *the intelligent handling of common stocks and other types of equities requires a higher and somewhat different type of investment skill than that required in the purchase of fixed-dollar media.*

This required type of investment skill is not likely to be built up overnight and an institution embarking in this field should be content to crawl before it walks and walk before it runs.

The writer believes that a strong case can be made for a substantial amount of equity investment by life insurance companies aside altogether from inflationary implications.

Most economists today recognize that our economy does contain strong forces which make further inflation on some scale a strong possibility and some of them consider it a probability. One well-known professor of economics, in the course of a lecture to the Life Insurance Investment Officers Seminar, expressed the belief that modern governments lack either the will or the ability to maintain the value of their money. Many people and institutions desire to hedge against this in their investment and pension programs and many are already doing so. This is something which the life insurance business cannot very well ignore insofar as its technical operation and investment policy is concerned.

Here is an experienced life insurance executive with a realistic approach to the problem. Inflation is robbing the dollar of its real value, he observes. Further, unless the institution of life insurance can develop a built-in hedge against inflation, it might be best for it to discontinue offering itself as a savings or investment medium and stick to providing pure protection.

Those policies which run longest between the premium-paying period and the receipt-of-benefits point suffer the most, because the longer such period, the greater toll inflation takes of the dollars involved in the policy contract. Endowment policies, which place principal emphasis upon life insurance as an investment, suffer the most. Term-insurance contracts suffer the least, having no cash values to depreciate.

Over almost any 20-year period selected, a portfolio of reasonably well-managed common stocks will easily out perform any guaranteed-cash-value insurance policy, he admitted.

In *Life Insurance and Annuities from the Buyer's Point of View*, the American Institute for Economic Research discusses the subject of inflation and life insurance at some length, and concludes:

The more significant justification for a predominant use of term insurance in meeting today's needs is provided by the long term future economic outlook for our country. During the past 3 decades many billions of dollars of life insurance protection have been embezzled through the insidious process of inflation and the political expedient of devaluing the dollar, and the probability is great that the

current buyer of permanent insurance will suffer similarly before the nation restores sound money-credit policies.

Until such time as the nation restores sound money-credit conditions and evidences a fixed intention to prevent more inflating, we do not recommend any other than term insurance for any purpose.

In most instances term should be used to provide not only for temporary needs, but also for those more permanent requirements, a part of which may continue to exist during the policyholder's productive years. The flexibility of renewable term insurance and its low premium outlay fully warrant its predominant use under today's economic conditions in all well-planned life insurance programs.

Some Solutions

In its nationally circulated *Economic News*, the Institute suggested:

> With reference to life insurance, you may wish to cancel endowment and ordinary life policies after first obtaining new term insurance policies, possibly in greater total amount in order to increase protection for your potential widow and orphans against more inflating.

Deane C. Davis, president of National Life of Vermont, urged the industry to be realistic about insurance, stocks, and inflation. Speaking at a company sales meeting at Hollywood, Florida on March 23, 1962, he said:

> I believe that the life insurance business will be more successful in this argument [common stocks and mutual funds as an inflationary hedge] when it gets down to cases and admits that, in short periods of time contemporaneous with rapid and continuous inflation, common stocks do represent temporarily a certain measure of hedge against inflation.

Inflation increases the need for insurance. As the dollar declines in purchasing power, it takes a constantly increasing number of dollars to assure the maintenance of a minimum living standard for beneficiaries when the breadwinner is gone.

If you are convinced that you have exactly enough insur-

ance today, you should reflect thoughtfully upon the fact that it will probably not be enough tomorrow. If you die today and your family is living on the income from your insurance ten years from now, the income which you now consider adequate will be inadequate by the standards of that time. You must carry *more* insurance than you need today so that it will still be enough in the tomorrows when your family may be living on it.

The only hope you have of accomplishing this is by buying pure protection—maximum protection at minimum cost. Insurance is vulnerable to inflation—there is nothing you can do about that. But you *can* avoid the types of policies which are most vulnerable and concentrate on the type which is least vulnerable.

Insurance comes before everything else, before savings bank accounts, before U.S. savings bonds, before the accumulation of emergency funds, before investment.

The financial security of our country is merely the sum total of the financial security of its individual citizens. If through the misuse of life insurance, a large segment of our population comes to depend upon a form of "security" which is more apparent than real, we shall all suffer in the end.

Chapter 21

Dividends

WE HAVE Uncle Sam's official recognition of the fact that the word "dividend" is a misnomer when applied to distributions made by insurance companies.

Section 316 of the U.S. Internal Revenue Code reads:

(A) DIVIDEND DEFINED

For the purpose of this sub-title, the term "Dividend" means any distribution of property by a corporation to its shareholders—

1. Out of its earnings and profits accumulated after February 28, 1913.
2. Out of its earnings and profits of the taxable year, without regard to the amount of the earnings and profits at the time the distribution was made.

(B) SPECIAL RULES

1. Certain Insurance Company Dividends. The definition in subsection (A) shall not apply to the dividend as used in Sections 803 (E), 821 (A) (2), and 832 (C) (11) where the reference is to the dividends of insurance companies paid to policyholders.

It is difficult to understand how the term came to be applied to insurance distributions in the first place. A not unreasonable assumption is that it was intended to create an impression that the sum distributed represented in some way a profit on money deposited or invested.

Horne and Mansfield, in their book *The Life Insurance Contract,* explain:

> The term "dividends" as used to describe the periodic amounts by which participating policyholders are permitted to share in the underwriting savings of the insurer, is perhaps not well chosen. . . . [It] is in effect a refund made to the policyholder of those portions of the premium which were included in the first place to provide a safety margin

against unforeseen contingencies and possible unfavorable experience.

Solomon S. Huebner, dean of the Wharton School of Finance and doyen of insurance educators in America, writes in *Life Insurance*:

> The use of the term "dividend" is unfortunate, since the refund to a great extent does not arise from the deviations of actual experience from expected experience but from the deliberate overcharge made in the premium rates.

In *Life Insurance*,[1] Joseph M. MacLean writes:

> The word "dividend" is to some extent a misnomer, the dividend on a participating policy being rather in the nature of a refund and not a return on an investment as the term is generally used in commercial transactions.

In *Modern Life Insurance,* Mehr and Osler write:

> That portion of the companies' surplus which is not deemed necessary to strengthen contingency reserves may be distributed among individual policyholders. The method of calculating dividends is rarely, if ever, stated in the policy contract. Instead, the policy makes some such statement as: "This policy on each anniversary while in force, except as extended term insurance, shall participate in the divisible surplus of the company, but payment of the first dividend shall be contingent upon and proportionate to the premiums due and paid for the second policy year. The company will annually determine the dividends of such surplus apportionable to this policy."
>
> In the case of participating policies, gains are not profits in the usual sense of the word because a certain portion is expected to be returned to the policyholder as an adjustment for an overcharge of gross premium. As a result, if a company assumes a high rate of mortality on participating plans and actually experiences a lower rate, the gain is not neces-

[1] 9th ed. Copyright 1962, McGraw-Hill Book Company. Used by permission.

sarily a profit to the company because the majority of the gain might be returned to him in the form of a higher dividend.

In his *Life Insurance,* John H. Magee adds his confirmation:

> Dividends therefore are not profits in any proper sense. They represent a yearly return of an overcharge in the premium.

We've pretty much established, then, that the "dividend" on your life insurance is not really a dividend at all but simply a form of refund of an overcharge on your premium. You will note that Mehr and Osler said that "a certain portion" of the overcharge is "expected" to be returned. How much of it? Well, the "majority" of it "might be" returned. There are obviously a lot of *ifs* between the policyholder and a refund of the entire overcharge.

This "dividend" is one of the phenomena of the life insurance business. Stock life insurance companies, as we know, are privately operated for profit; mutual life insurance companies are cooperative affairs, operated solely to provide life insurance protection at cost for their policyholders. Since both types of companies use the same mortality tables, obviously, both should charge the same base rate for the insurance protection they sell. The operating profit should be passed on to the shareholders of the stock company as a dividend on their stock, and to the policyholders of the mutual company as a dividend representing their share in the profit generated by the cooperative enterprise.

Both types of companies insure the same kind of risks under identical types of policies. The premiums should be the same.

They are not.

For some curious reason, the mutual companies charge a premium approximately 15% to 25% higher than that charged by the stock companies. Then, at the end of the year, they make a refund to the policyholder of a *part* of the overcharge and they indicate to him that this is his share of the profit generated by this cooperative enterprise in which he is a participant. It is not a share of the profit—if it were, it would be taxable just like any other dividend. It is purely and

simply a refund of a part of the overcharge on his premium, as all of these experts have just testified.

In other words, the mutual company is *not* distributing its profits. If it is not distributing its profits, what *is* it doing with them? If the operation is not in fact a cooperative enterprise, if it does *not* distribute its profits, by what right does it advertise itself as a mutual company and represent that it is owned by its policyholders and operated for their benefit?

If mutual companies sell life insurance at cost, how do all the stock companies survive when they obviously must be selling insurance *below* cost, since their rates are lower than those of the mutual companies?

If you have a $1000 policy in each of two companies, one a stock company and the other a mutual, should you not be getting your insurance cheaper in the mutual company than in the stock company? Should you not be getting the dividend or other distribution of profits which in the stock company goes to its stockholders?

What kind of regulation do we have which has permitted this monstrous fraud to be perpetrated upon the American public for more than a hundred years? Why has no one ever demanded that mutual companies actually *be* mutual and distribute their profits to their policyholders?

Dividend Projections

The mutual company frankly admits that it is overcharging you. It promises to refund a part of that overcharge. It may, in fact, give you a schedule showing exactly how much it will refund to you each year over the next 20 years. If mortality experience and investment return in the future are both unknown quantities, how can the mutual life insurance company give you a schedule of the amounts it expects to refund to you over the next 20 years by reason of its savings in these two fields?

In connection with these projections of future dividends, it has long been recognized that the mutual company has a moral obligation to draw your attention to the fact that its "guesstimate" is in no sense a guarantee—or even an estimate. A note to this effect is supposed to appear on each dividend projection given to a prospect. However, this cautionary note has come to be regarded as old-fashioned and

the practice is now more honored in the breach than in the observance. As a result, millions of buyers of life insurance are being swayed in their decisions to purchase by fanciful projections of dividends which haven't a prayer of a chance of being realized.

Mutual companies respond to the charge that they are profiting from the use of obsolete mortality tables by insisting that the savings resulting from the improved mortality experience is being passed on to policyholders in the form of dividends. If this be so, then dividends paid today on policies taken out 30 years ago should be far greater than those the companies illustrated in the dividend projections issued at the time.

In 1960, the mortality ratio of all American companies was 48.6%. That means that instead of the 100 people they assumed would die when they determined their premiums, only 48.6 people actually did die. With this tremendous saving in mortality, you'd naturally expect that dividends would have climbed. After all, if mortality is cut in half, dividends should double.

They haven't. As a matter of fact, despite this unexpectedly favorable mortality experience, most companies have paid *less* in dividends than they led the policyholders to expect in the projections given them when they bought the policies many years ago.

In a recent survey conducted among members of the Association for Advanced Underwriting, a national organization of life insurance salesmen, the members were asked to account for the tremendous turnover of policies. A significant 27% charged the lapse rate to "dividend projections which project net costs never yet achieved by the issuing company."

Mind you, this damning indictment of deceptive dividend projections did not come from outside the industry. These are the men who sell life insurance to the American people. These are the men who hand you the dividend projection and ask you to believe it. More than a quarter of all these thousands of insurance salesmen across the country found the insurance companies in effect, guilty of fraud.

In his book *Discrimination: A Study of Recent Life Insurance Developments,* Halsey D. Josephson, general agent in New York for Connecticut Mutual Life, wrote of the 1950s as:

> . . . a decade of competitive shenanigans, cloaked in sanctimonious rationalization [and marked by] the unrestricted right to illustrate dividends on the basis of nothing more than fantasy.

The *National Underwriter* (November 4, 1961) reported from an address by E. J. Moorhead, actuary of New England Life, at a Chartered Life Underwriters luncheon in New York:

> If any company publishes a dividend illustration for a newly introduced policy form that is out of line with dividends being paid on older policies, only a naive and uninformed field man could suppose that the new policy will actually get some kind of a bargain in dividends as the years go by. The company will pay what it finds it can afford to pay—dividend illustrations to the contrary notwithstanding.

The American Society of Chartered Life Underwriters distributes a column of "information" to newspapers throughout the country. Recently, the writers answered a question about dissimilar dividends on like policies with the following interesting explanation: "Just how much surplus will be paid in policy dividends is an individual company decision—influenced to some extent by competition with other companies."

Just in case you were thinking that there was some formula by which overcharges made on the premiums you pay are returned to you, just in case you were thinking that the only thing which determines the amount of the dividends you receive is an actuarial accounting which establishes what is rightfully yours, you now have been set straight. It is competition with other companies that determines what you get. Neither you nor any state regulatory agency has a voice in determining what you will get as dividends.

Did you ever get a letter from an insurance company saying "We find that we paid you too much (or too little) on your last dividend; you should have been paid x dollars"? How come? Don't these people ever make a mistake in apportioning to each of the millions of policyholders his proportionate share of the surplus being distributed? You never received such a letter because you have no proportionate share to which you are entitled. They pay you what they like, what is

dictated by the needs of competition—and they swallow the rest.

The CLU newspaper column had this question-and-answer exchange:

> QUESTION: 13 years ago, at age 52, I took out an endowment policy that would be paid to me at age 65. I have paid a total of $3380 in premiums and the company now informs me that the sum I am to receive is $3121.87. The agent I bought the policy from attached an illustration form indicating that I would get $4390, plus or minus a few dollars, according to the fluctuation of dividends. In my opinion, almost $1300 is too much fluctuation. What do you advise me to do about this?
>
> ANSWER: Furnish the company that issued your policy a copy of the dividend illustration you were given. No life insurance company can guarantee the amount of policy dividends it will return (either as a practical proposition or under state law) but this difference of $1300 is substantial and we don't wonder you are questioning it.
>
> It's too bad that a good result can be made to seem unsatisfactory by a salesman's estimate—one that must have been either a mistake or an instance of supreme overoptimism.

This questioner has paid in $3380. He is now going to receive $3121.87. CLU says: "It's too bad that a good result can be made to seem unsatisfactory by a salesman's estimate." Good result? Made to *seem* unsatisfactory? Is he kidding?

Agents say a great deal more than their prayers, but they don't generally monkey around with the dividend estimates. These come right out of the company manuals. This aggrieved policyholder shouldn't bother writing letters to the company. It will just softsoap him with a long, windy explanation couched in insurance lingo that he won't understand. He should just take the policy and the dividend projection to a smart lawyer and offer to split 50–50 on everything the lawyer gets. The lawyer should then write to the company and say: "You and your authorized agent deliberately misled my client into making an investment on which he has lost money. Instead of paying him the dividends you agreed to pay, you've used the money to help pay exorbitant commissions to agents who have been putting new business on the books, new busi-

ness that means nothing at all to my client. The dividends which were rightfully his by reason of the fact that your mortality experience has steadily improved since he bought the policy while your investment earnings have been climbing to an all-time high, were improperly used for sales promotional purposes. Either you pay my client the dividends you agreed to pay him in this projection or be prepared to send your actuary down to explain to a jury here in Smithville how you came to make an 85% error in figuring the dividends on this contract. Maybe some of the people who will be on the jury have this same policy and it will save you having to explain it to them individually."

Whatever you do, don't send the company the original dividend projection. Send them a photostat. They may buy abstract impressionist art for the home offices but don't expect them to buy original dividend projections if the latter are no longer in your possession.

In 1931, Mr. Minot B. purchased a retirement-income-at-age-65 policy from Phoenix Mutual. The agent gave him a dividend projection supplied by the company which indicated that if he allowed dividends to accumulate, the policy would be paid up at age 56.

Mr. B is now age 63 and has finally been advised that he need not pay the premium next due, the last premium on the policy. So the dividend projection of a total sum equal to nine times the $488 premium ($4392) has turned out actually to total enough to pay one year's premium. That's a pretty wide margin of error, don't you agree?

I wrote Benjamin L. Holland, president of Phoenix Mutual, commenting on this poor dividend performance. He replied acknowledging that the dividends actually paid represented a substantial variance from the 1931 scale and ascribing this to a downturn in interest rates.

Granted that no company can foretell what its mortality experience or earnings will be, the only question involved here is whether insurance companies should be permitted to make representations that they expect to pay certain dividends and then fall *that* far short. Granted that interest rates did decline. Actually, have we not seen the testimony of innumerable experts that the dividend is a refund of an overcharge? Should not Mr. B have been entitled to his refund regardless of earnings fluctuations? He was charged a premium 25% higher than would have been charged him by a

stock company which paid no dividends. The purchaser of such a policy from the stock company was assured of his "dividend" since he never had to give the company the overcharge in the first place. Yet despite this, the stock companies stayed in business and made money.

The Money Rolls In

In 1960, Phoenix Mutual enjoyed a mortality ratio of 34.6%. It collected enough premiums to pay 100 death claims, but had to pay only 34.6. Should not this wonderful mortality saving have made up for any decline in interest earnings?

The insurance company makes money on mortality savings, it makes money by releasing to policyholders only part of the reserve on surrendered policies, and it makes a profit by earnmium rates on an assumption of earning only 2½% on such reserves. It claims that all of these windfalls are passed on to the policyholders in the form of dividends. Mr. B didn't get ing 4.22% (in 1961) on its investments after basing its preany windfall though, nor have millions of other policyholders like him.

The Temporary National Economic Committee of Congress took a look at the question of stock company versus mutual company and concluded:

> In every case, the annual premium is higher on the participating than on the non-participating insurance. This is the result of a custom existing among most mutual companies in the industry to add an extra large loading to the net rate. . . .
>
> Why this should be done year in and year out without change does not appear. The rate adopted by the non-participating companies is presumably not only adequate but profitable, for the non-participating companies are obliged, if possible, to make a profit for their stockholders. There is no compelling reason why the initial premium charged by the mutual companies should be so much higher. Some difference for contingencies may be desirable but the margins appear all out of proportion, particularly in the case of the high-gross-premium mutual companies.
>
> While no necessity for the practice appears, however, some effects of it can be observed. In the first place, by

making ample funds available for administrative expenses, it enables the mutual companies to pay generous salaries and high commissions. At the same time, it enables the companies to pay larger dividends, creating the illusion of very profitable operations, and giving the policyholder the impression that he is receiving a windfall.

This custom of charging higher-than-necessary initial premiums not only deprives the policyholder of the interim use of his money and repays him only approximately in proportion to his contribution, but it is a direct item of expense. As one witness expressed it,

> ". . . you can never return to a policyholder in its entirety the additional amount which you have collected because the agent gets his commission, the government steps in and gets taxes; it costs a good deal of money to adjust these, to arrange these dividends and distribute them again. Then how can you pay back to the policyholder the overcharge?"

Another effect of the extra premium charge becomes apparent in the light of the studied effort of many companies to avoid cost competition. If the initial premium rates of mutual companies approximated those of the nonparticipating companies, the latter would be forced to lower their rates as far as possible, and a true cost competition, based on efficiency of management, would necessarily result. This the companies seem particularly anxious to avoid.

As a result of the efforts of the companies, competition on a cost basis is greatly minimized in the field of life insurance, and the policyholders' difficulty in determining net cost and comparative costs is correspondingly increased.

To the extent that a prospective policyholder cannot determine costs, or even make intelligent estimates of cost, he cannot purchase his insurance on the basis of cost, with the result that the prices of the commodity cannot react to competitive factors.

The insurance regulatory bodies in the United States are concerned only with minimum, or safety, rates. They do not attempt to control maximum rates. The actual effective rates are left to the discretion of company managements,

and are sometimes actually arrived at by concerted action designed to eliminate competition.

In 1960, after paying all claims and expenses and adding heavily (nearly $5 billion) to reserves, the mutual companies ended up with $2.7 billion left. Supposedly, this belonged to the policyholders. Only 60% was actually paid to them, however. The other $829 million disappeared in the quicksand of "unassigned surplus" and may never be seen again.

In the case of Metropolitan, this net gain after dividends—the policyholders' money which the company failed to distribute—was $76 million. Prudential's undistributed net gain was $112 million, Equitable's $41 million.

Between 1940 and 1960, American life insurance companies refunded to policyholders as "dividends" a total of $16.8 billion representing overcharges on premiums. It is not possible to compute what amount of the total overcharge was never returned. The important fact is that the companies had this enormous amount of money in their possession—and put it to work and made money on it—and didn't have to pay the policyholders one cent for its use! In 1960, the companies refunded $1.6 billion in overcharges. The net earning rate of life companies in 1960, as disclosed by the *Life Insurance Fact Book*, was 4.11%. On the $1.6 billion which the companies borrowed without interest in 1960, they made $66.6 million!

Speaking of the investment possibilities of life insurance company stocks, Best's vice-president Raymond T. Smith wrote in his book on the subject:

> It should be remembered that premiums on participating insurance are considerably higher than are premiums for non-participating, so that much higher earnings are to be expected on this class of insurance.

In an address to the Chicago Analysts Society, Smith said:

> Cash dividends payable to shareholders are generally limited to an amount smaller than the interest earned on invested assets. Other earnings are plowed back into the business. The cumulative effects of these reinvested earnings on the normal profit earned on purely insurance oper-

ations is one of the most important factors in the stability and high growth potential enjoyed by investors in life insurance stocks.

All of the policies sold by mutual companies are participating, therefore these companies enjoy the much higher earnings which Smith first mentions. Like the stock companies, they plow back most of their earnings. In the case of a stock company, according to Smith, these reinvested earnings are an important factor in the high growth potential of stock companies. What are they in the case of the mutual companies? Where do those earnings go? Why isn't a mutual company just as profitable for its policyholder-owners as the stock company is for its stockholder-owners?

Overestimating Is Universal

In a period of high yields during the 1920s, dividend projections were high. When the cycle swung around to a period of low yields, the companies reneged on these projections. They grew cautious and lowered their newer projections. As the high yields of recent years returned, the conservative projections of 1932–50 were easily achieved and in many instances surpassed. Now the companies are back in the same financial frame of mind as in the 1920s and it is quite likely that another whole generation of policyholders will have the dividend rug pulled from under them a few years hence.

Nothing I have written is intended to convey the impression that failure to pay projected dividends is peculiar to any one or two companies. Thirteen major companies estimated dividends averaging $17.50 over a 20-year period on a 20-year endowment policy. The actual dividends averaged $3.83.

Harwood and Francis, in their book *Life Insurance and Annuities from the Buyer's Point of View,* cautioned:

> It should be remembered, of course, that no company guarantees its dividend scale. A low-cost company on the basis of its present dividends may find it necessary to reduce its dividends, and thereby become a high-cost company.

Harry V. Wade, president of Standard Life of Indiana, told

the American Life Convention in October 1962 (reported by the *National Underwriter*):

> Let us be realistic and appreciate the fact that those of us having had some connection with participating life insurance might have had some of our perhaps over-enthusiastic salesmen represent to our policyholders a certain dividend performance that we haven't always been able to produce. However, this . . . certainly hasn't caused any great degree of embarrassment to the life insurance business and I doubt if many policyholders have lapsed their business and lost their confidence in us because our dividends haven't held up the way that we would have liked them to at all times.

Reading between the lines of this tongue-in-cheek reference to "over-enthusiastic salesmen," do you not feel a strong sense of revulsion at the calloused cynicism of this industry-gone-wild, luring generation after generation into its web with utterly fictitious dividend projections which field men and home-office men alike know will never be realized? Where is the morality of it? Where is the legality of it? How much longer will the American people let them get away with it?

Fred C. Crowell, Jr., president and editor of *The Insurance Field,* editorialized about the practice of using exaggerated dividend projections:

> Something should be done to put an end to this vicious practice. . . . Just because life underwriters have developed a bad habit, and a bad habit is hard to break, there is no excuse for perpetuating a management mistake. It is injurious to the public. It surely isn't doing the industry any good. As a matter of fact, continuation of this practice is an open invitation for extended regulation.

You can understand the interest of the insurance man in selling you a policy in a mutual company with a 25% higher premium. His commission is a percentage of the total premium. Any refund the company eventually returns to you is figured after taking into account his commission on the overcharge.

Here is an interesting illustration of the phenomenon of mutual insurance: in 1940, Pacific Mutual (then a stock

company) quoted a nonparticipating rate of $44.18 on a 20-year endowment. Then the company became mutualized and quoted a participating rate of $49.85 on the *same policy,* reduced by dividends over the next 20 years to a net rate of $44.77. The company sold the insurance cheaper when it was a stock company operated for profit than it did as a mutual company selling protection at "cost" to its policyholder owners!

Variations on the Dividend Theme

In the early days, companies paid "deferred dividends." Dividends were paid in the fifth, tenth, fifteenth, twentieth, etc., years, and you had to be in for the full 5-year period or you forfeited the refund of the overcharge for whatever portion of the 5-years had actually expired.

"Terminal dividends" were, and are, another racket. These are paid only if and when you surrender the policy. The terminal dividends are reflected in the 20-year net cost figures shown by the companies, even though you have to surrender the policy in order to get them and thus realize the projected "net cost."

The terminal dividend is presumably simply a deferred refund of the overcharge. If that be so, how do you explain that many companies will not pay it if you wish to take advantage of a nonforfeiture provision other than cash surrender—paid-up or extended insurance, for example? Why should they pay you the refund to which you are entitled only if you elect one particular nonforfeiture provision and not another?

Tables of 20-year average "net cost" reflect the total accumulation of dividends without showing how they are paid. You are left with the impression that they are spread evenly over the whole 20-year period. Far from it—Prudential, for example, shows a $2000 dividend accumulation in 20 years on one of its policies. Actually, they pay $350 during the first 10 years and $1650 during the second 10. In other words, to realize the illustrated net cost, the insured would have to survive the 20 years and then *surrender* the policy promptly. If he surrenders it earlier or later, his net cost will not be the same.

A number of companies issue a freak contract with a page of "guaranteed coupons," handsomely engraved to simulate the coupons on a bond. In the case of Franklin Life, these

serve to heighten the misunderstanding created by labeling the policy "President's Protective Investment Plan." When you label a 20-payment life an investment plan and give the policyholder a page of coupons to clip, you're really trying hard to make him understand something, aren't you?

Well, these coupons guarantee that the company will pay you a specified sum each year. They resemble dividends in every respect—same options (take them in cash, apply them to reduce the current premium, leave them to accumulate at interest, use them to buy paid-up additions) as apply to regular dividends—but they aren't called dividends. They're "guaranteed coupons."

Obviously, they appear to be dividends, *guaranteed* dividends. Ah, but the law doesn't allow a company to guarantee dividends. That's easy—don't call 'em dividends, call 'em coupons. I hate to keep harping away at the fact that dividends are a refund of an overcharge, but they *are,* and obviously no company can know ahead of time what they will be. It must wait and see how it makes out with its mortality experience and its investment earnings. How could these companies issue contracts calling for the payment of specific guaranteed amounts over a 20-year period if they were really dividends?

The answer, of course, is that these are phony dividends. They represent no "margin of safety," no extra amount which the company may need. They can't be, for the company cannot keep them. It must pay them back at the end of each year. If the company can't keep them, what good are they? The answer is simple—each year, thousands of gullible people clip a coupon and send it to the company and somehow manage to lose sight of the fact that this is their own money, paid to the company last year, which is now coming back to them without interest. Get thousands of people lending you money at no interest for a year, year after year, and you've got a pretty good thing going.

Not long ago, at a meeting of the Chicago Life Underwriters, John P. Weaver, president of Illinois Mid-Continent Life (which sells a coupon policy), raised a rhetorical question of what is wrong with a coupon policy; according to the *National Underwriter* for February 17, 1962, he "was answered by a shout of 'gimmick' by someone in the audience. . . . Weaver replied that everything in selling is some

kind of gimmick. 'Why get mad at a piece of paper? A coupon on a policy can do everything that a dividend can do.' "

What shall we say of a state insurance department which allows such a policy to be sold when the state's insurance laws prohibit an insurance company from guaranteeing dividends?

William Montgomery, while president of Acacia Mutual, addressed the American Life Convention, saying:

> There is a well-defined feeling all over the land, a feeling that is increasing in volume and intensity, that the cost of life insurance can and should be reduced.
>
> In the early years of life insurance, when the business was small and not understood as it is today, when the country was new, when we were subject to epidemics, such as smallpox, yellow fever, etc., when property values and interest earnings were not stablized, when experience had not tested the mortality tables to prove their sufficiency, it was fitting and proper that the companies should charge a premium large enough to guarantee security beyond question and a surplus to provide against unforeseen contingencies. But in this day and generation, with the mortality tables having been proven more than sufficient, and notwithstanding the greatest war of all time, with property values stabilized and the possibility of epidemic removed, there would seem to be no good reason or excuse for the system of continuing to collect from the public a larger premium than is necessary to guarantee safety, stability and perpetuity, yet this is just the system being pursued by the mutual companies today. True it is that an endeavor is made through dividends to return this overcharge at a future date, but why collect it in order to return it? As a matter of fact, it is impossible for any company to return all of it. The agent gets his share in commissions, the state gets its share in taxes, and there is the home office cost attendant upon collecting it, accounting for it and returning it to the policyholders.
>
> The fallacy of the whole proposition is shown by the fact that some companies attempt to pay a dividend, as a return of part of it, at the end of the first year. If they did not need it, why did they collect it, use it for a year and return part of it? If it was necessary to the safety and

perpetuity of the business at the beginning of the year, it was just as necessary at the close. The agent's commission and doctors' fee, inspection fee, the expenses of issuing the policy, and the reserve charged against it have taken at least all of the first year's premium. Where, therefore, has the money come from to pay the dividend? The only place it can come from is out of the general surplus of the company, which the older policyholders have accumulated, and it does not seem fair or equitable to take from an older policyholder any part of his surplus to give to a new one just coming in.

This system certainly cannot be defended on the theory of safety. The stock companies are an unanswerable argument thereto. If the larger premiums charged by the mutual companies are necessary to safety, then the stock companies with their lower initial premiums must be unsafe and they should not be allowed to continue in business. But certainly no sane person will contend that they are not safe, nor can it be successfully contended that the amount paid in on the capital stock of these companies in proportion to their assets and volume of business in force contributes materially to the safety of the policyholder.

Competition between all companies . . . ought to be on the basis of economy of management and not, as at present, on dividend estimates which may or may not be realized, and dividends paid would be actual earnings. The merchant or manufacturer who would charge more for his goods on the theory that he would return to his customers all or a part of the overcharge at a future date would not make many sales, especially so when the amount of the overcharge that he would return would be entirely at his own discretion. Mutual life insurance should be sold as any other commodity. At present it is sold largely through a system of dividend promises that many of the agents who sell it do not understand and generally enlarge upon. The public sees so many kinds of dividend schedules and they hear so much from the agents of competing companies about low net cost, dividends, etc., that they are mystified about the whole proposition and seldom have a real, intelligent conception of what they are purchasing. If mutual insurance were sold at the lowest possible cost, irrespective of future dividends, the public would be saved an enormous amount of money each year that they could use to pay for the

other necessities of life or use to buy additional insurance. The companies would be saved the enormous amount of time and money that has to be spent in compiling and presenting these schedules to the public. They would be saved all the time that is now wasted training the agents how to use them to the best advantage to make the sale, and the agent would be saved the time that he has to spend in trying to explain them to his prospects. It would also effectually remove the possibility of disappointment on the part of the public as to future dividend payments because, with the decrease in interest rates, it is difficult to see how dividend schedules based upon the high interest rates of the past few years can be maintained, unless there should be a decided saving in mortality or a decided economy in expenses of management. I hazard the prediction if these dividend schedules were eliminated and the same time and energy that is spent in the home office in preparing them and in educating the agents regarding them, and by the agents in trying to explain them to the public, was spent in selling real insurance, explaining the need for it, its benefits and its cost in a plain, simple manner to the public, a great deal more insurance would be written, the volume of business would be increased, the public would be saved a great deal of money, and the agent and the company would profit thereby.

I believe sooner or later the public will realize the inequities of the system and will compel a change therein, because they will refuse to generously patronize companies using it. The system is conducive to waste and extravagance in management. It is not good for the public and cannot be good for business.

James A. Fulton, president of Home Life, had a pithy comment about dividend projections at a company convention at Atlantic City:

> Policy dividends owe their existence to the same thing that makes their projection meaningless. This is the inability of anyone to predict accurately the factors which will determine the cost of insurance.

Harold J. Cummings, president of Minnesota Mutual, voiced his views on dividends and net cost projections at the American Life Convention:

Net cost comparisons, however plausible, are inconclusive if not misleading, ill-advised if not fictitious, deceptive of not deceitful, asinine if not downright dishonest.

Can an informed and sincere company or agent, or can the industry, hope to hold the confidence of the public and continue to urge prospects or policy owners to make decisions based on figures that all know, or ought to know, are so certain not to be so? And what about the company or agent that bases cost comparisons at one time on the current and at another time on the historical dividend scale? Can such surrendered net cost figures be called anything less than specious? How the life insurance business ever brought itself to keep a straight face while ignoring differences in contractual benefits, changes in dividend schedules and all the other variables, presenting surrendered net cost figures to each prospect as if they were truly a measure of relative future "costs" between companies which could be determined today in precise dollars and cents, it is difficult to understand.

Many big companies discontinued paying dividends on policies which had been issued some years ago, particularly those which had been paid up. They claimed that the low interest rates of the 1940s and early 1950s left no divisible surplus for these older policies. Now that interest rates have rocketed and average return on their investments has climbed well above their original estimate, you'd expect that the improvement would be reflected in the refunds to policyholders. You'd think they'd be paying higher than the projected dividends. Actually, many have not even resumed payment. They just got out of the habit of paying dividends. Since nobody but they themselves knows who is entitled to a dividend and how much, they just drift happily along without a care in the world, adding new millions to surplus.

In the competitive scramble for business which has marked the last few years particularly, a number of the largest mutual companies have announced premium-rate reductions. This has not meant that the policyholder was obtaining his life insurance any more cheaply. The premium "saving" was more apparent than real. As a Mutual Life of New York actuary explained it to me, "A change in premium rates is normally accompanied by a corresponding change in divi-

dends." What you gain on the swings, you lose on the roundabouts.

Of all the life insurance in force in this country, 67% is "participating," and 61% is in mutual companies. The difference in figures simply reflects the fact that to compete with the mutuals, most stock companies issue a line of "participating" contracts which pay dividends. This is a sop to people who "buy dividends."

Dividend Options

There are four standard dividend options. You can:

1) Take them in cash
2) Use them to reduce the next premium
3) Allow them to accumulate at interest
4) Use them to purchase paid-up additions.

Some companies have a fifth option—you may apply the dividend credit toward the purchase of one-year term insurance. This last option has been somewhat controversial among companies and is not in widespread use.

Your best bet is to use your dividends to reduce premiums. Use them to purchase paid-up additions only if you have become uninsurable and need more insurance. Under any other conditions, paid-up insurance is not a bargain; it's simply a little single-premium insurance policy—than which there are few things worse.

Some people leave their dividends to accumulate at interest. This is just another savings account, except that ordinarily it doesn't pay as much as you'd get for it from a savings bank. A surprising number of policyholders borrow on their policies and at the same time accumulate dividends. They borrow from the insurance company at 5% while at the same time they are lending money to the company at 2½% to 3½%. Is it any wonder that so many people end up broke at age 65 when they do things like that?

The insurance man will encourage you to allow the dividends to accumulate. This will permit him to come back to see you as soon as you have a little credit in your accumulation account to invite you to use said accumulation to pay the first premium on a new policy. In the insurance business, this gambit is as traditional as the rope trick in Bombay.

Read Your Policy

When it comes to dividends, read your policy carefully. Remember the old saw: They give it to you in the big print and take it away in the small print. A Metropolitan contract called the Young Business and Professional Man's Policy reads:

> "This policy is a participating contract, except when continued as Extended Term Insurance."

(Good, you're going to get a dividend!)

> "The Company will annually ascertain and apportion any divisible surplus accruing on this policy. Any such surplus will be payable as a dividend on the policy anniversary at the end of the policy year, on condition that the policy is then in force with all due premiums paid to such anniversary."

(That's dandy, you're going to get the dividend every year!)

> "NOTE: This policy is participating from its date of issue."

(Great! They're going to pay a first-year dividend!)

> "but, owing to the low rate of premium payable during the first five policy years, it is not anticipated that there will be any surplus available for an annual dividend on this policy until at least five years from the date of issue."

(Well, I'll be ———!)

Can't you just hear the Kingfish reading that contract to Andy? "Now, le'ssee, Andy. It says here that we is goin' to pay you a dividend every year right from the beginning, except that we ain't goin' to pay you none for the first five years or so—maybe a little later. Now, sign yo' name right here, Andy."

Young Business and Professional Man's Policy? They *have* to sell it to them young—before they've learned to read!

Word of Warning

If you're estate-planning-minded, you might want to bear in mind that most companies consider accumulated dividends the property of the insured, not the beneficiary. If the insured dies, the dividends are paid to his estate. That means that they'll be tied up in probate until the estate is settled and be subject to all of the costs of estate administration—another reason for not leaving them with the company.

Life insurance should be cheaper when purchased from a mutual company.

It isn't.

Until such time as it is, buy guaranteed-cost policies from a stock company.

Chapter 22

Nonforfeiture Provisions

In 1705, the Acacia Assurance Association was formed in England to provide the first level-premium life insurance. Under this system, you pay higher-than-necessary premiums during the early years of a life insurance contract in order to have the convenience of paying lower-than-necessary premiums in the later years. For most of the years since then, it has been the practice of the insurance industry just to forget about the advance payments imposed by the level-premium system if and when a policyholder abandoned his insurance. The companies pocketed them.

Finally, the insurance commissioner of Massachusetts demanded that all such advance premiums be sequestered in a reserve and that they be returned to withdrawing policyholders. Elizur Wright insisted that it was just as much a company obligation to return advance premiums as to pay death claims, and he required companies operating in Massachusetts to set aside a formal reserve of funds earmarked as advance premiums. This was the beginning of the nonforfeiture provisions in life insurance. Actually, as we know, the cash value of a policy is not equal to the sum of the reserve of advance premiums and the reserve for such future endowment as may be called for by the policy. The company ordinarily levies a surrender charge against the reserve for the first 20 policy-years. You'd think that if you withdrew from a policy, you'd be entitled to a return of all premiums you had paid in advance. The company doesn't think so, though, and it punishes you for withdrawing by keeping an appreciable percentage of those advance premiums. Thus the company stands to benefit if you take your cash value, because you don't get all that you should.

One of the nonforfeiture options involves the termination of the policy and the protection afforded by it. The other two involve an alteration in the type of coverage but the protection continues. Regardless of which of the three options you select, the company still levies the surrender charge, since the

two options calling for continuance of the protection are based upon the cash surrender value—and it is against this that the surrender charge is levied. Thus we see that the company collects a surrender charge even from those who do not surrender.

In the early 1940s, the so-called Guertin Laws became effective, liberalizing cash, loan, and other nonforfeiture benefits. Prior to that time, the companies had generally provided no such values until the end of the third policy year. The laws advanced the provision of benefits to the end of two years or one year. A few companies provide an extended-term option for policies only six months old.

The life insurance industry has never voluntarily broadened its benefits or reduced its cost. It has fought like a tiger every effort to give the policyholder more for his money. Only in recent years, as the fantastic profits in the life insurance business have become more widely appreciated and a myriad of new companies have sprung up to compete for the premium dollars, has the growing competition led to a better break for the policyholder.

Three Options

There are three nonforfeiture options contained in all cash value policies. These options are required by law and the privilege of using them at any time cannot be denied legally by any insurance company. They are an important part of a life insurance contract and should be thoroughly understood by every policyholder.

All of these options provide for the discontinuance of premium payments. They are based on the guaranteed cash value and are shown in table form in every policy.

How these options may be used to advantage is best illustrated with the use of plain arithmetic. Descriptions of the policy used and the table values shown in the policy are as follows:

Twenty-Pay Life Policy	*Nonforfeiture Values at Age 50*		
$10,000 non-par	Cash value	$4530	Extended Insurance
Premium	Paid-up		26 years 197 days
$330.10 age 35	insurance	$7520	

1. *CASH SURRENDER OPTION*

The cash surrender option gives the policyholder the right to recover his cash value and discontinue the insurance. If there is no need for insurance this option can be very profitable.

The cash proceeds placed elsewhere, either in fixed or variable investments, will probably earn more and accumulate much faster than if left with the insurance company. Even if some continuing insurance is needed, this option generally proves advisable.

Situation at Age 35		*Situation at Age 50*	
Face amount of policy	$10,000	Face amount of policy	$10,000
Guaranteed cash value	—0—	Guaranteed cash value	4,530
Net insurance protection	$10,000	Net insurance protection	$ 5,470

The cash value of $4530 invested separately at 3¾% interest will produce income of $199.87 a year. This amount plus the premium savings of $330.10 will provide a total of $529.97 a year for living, spending, or investing.

By age 50 the insurance protection has reduced to $5470. New term insurance for this amount is available for premiums averaging from $55.08 to $114.70, depending upon the type needed. In the event of death, the beneficiaries would receive both the insurance and the separate savings or investments.

Your policy undoubtedly has a provision in it giving the company the right to defer payment of the guaranteed cash value for six months. In Chapter 6 we examined the conditions in 1933 which led the industry to renege on its promise to pay cash values on demand. The moratorium is now built in—they can take six months to give you back your money.

2. *PAID-UP INSURANCE OPTION*

The paid-up option provides continuing insurance for a reduced amount. Both the cash value and the earnings on the cash value are left in the hands of the insurance company. The earnings alone are sufficient to keep the reduced amount of insurance in force to age 100. In this example the amount of paid-up insurance is $7520.

Situation at Age 50		*Situation at Age 100*	
Paid-up insurance	$7520	Paid-up insurance	$7520
Guaranteed cash value	4530	Guaranteed cash value	7520
Net insurance protection	$2990	Net insurance protection	—0—

Under this option the policyholder forfeits the use of the income on his cash value and the family loses part of its insurance protection. On a 3¾% basis, the income lost is $199.87—the cost of the $2990 of insurance. This is equal to a rate of $66.84 per $1000.

Since renewable and convertible term insurance is available at rates from $10.07 to $20.97 per $1000, selection of Option One would seem logical. In any case, don't take a paid-up policy on a very old contract. The chances are that you'd do much better taking the cash value and buying a single-premium policy from a company using a more up-to-date mortality table.

3. *EXTENDED TERM INSURANCE OPTION*

The extended term option provides continuing insurance for the full face amount, but the policy terminates at the end of a definite period of time. The extended term period represents the number of years and days for which you have paid ahead under your level-premium policy. This option requires leaving the cash value and all earnings with the company, and in addition it involves using up the cash value during the period. In this example the period (term) is 26 years and 197 days.

Situation at Age 50		*Situation at Age 76—197 Days*	
Extended term insurance	$10,000	Extended term insurance	—0—
Guaranteed cash value	4,530	Guaranteed cash value	—0—
Net insurance protection	$ 5,470	Net insurance protection	—0—

The cost of this option may be calculated as follows: The cash value of $4530, if invested at 3¾%, will provide 26 annual payments of $271.80—using both principal and interest. In 26 years these payments would amount to $7066.80, which therefore is the cost of the $10,000 worth of extended insurance for the 26 years.

If the policyholder is uninsurable this expense may be justified, otherwise Option One would appear advisable.

When the policyholder is required to pay an extra premium or "rating" because of a health condition which the company feels makes him a substandard risk, the extended term insurance option frequently is omitted from the policy.

Policy Loans

The American people owe life insurance companies $5.2 billion which they have borrowed on their policies.

This is an economic fact—but it doesn't make much sense. In addition to giving the companies the cost of the protection provided under the policies, these people have given them extra dollars to be held for them in a savings account. On these extra dollars the companies generally pay 2½% interest—a few pay 3%. Then the people borrow the money back from the companies at 5% or 6%. Does it make much sense to borrow back your own money at twice the interest rate at which you are lending it?

Remember, the life insurance protection provided to the beneficiaries of these borrowers is reduced by the $5.2 billion which has been loaned to the policyholders themselves. More than 4.4% of the industry's entire assets—5.3% of all policy reserves—is being loaned to policyholders. In 1960 alone, policy loans increased by 14%. In that single year, policyholders paid nearly $300 million in interest on their own money.

Insurance companies are grievously hurt when critics mention that policyholders are paying interest to borrow their own money. They point out that their guarantee of an endowment amount at some agreed date in the future contemplates that they will have the use of the money all the years until then. If the policyholder insists upon using some of the money before that agreed date, he must in theory reimburse the company for the income which it would have derived from the use of the money had he not called upon it.

Let us examine this contention for a moment. The 1960 earnings rate of life companies was 4.11%. Insurance companies are fond of referring to their "family" of policyholders. When they lend money to strangers—on bonds, for instance—the interest rate they charge averages something less than 4%. But when a member of the "family" desperately needs to use

some of the accumulated savings in his policy, the company charges him a rate which averages 43% *higher* than it charged the stranger.

When it comes to borrowing money from an insurance company, it certainly doesn't pay to be one of the family!

M. Albert Linton, an industry oracle, discussed policy loans in one of his essays:

> The rate of interest at which you can obtain the loan is also guaranteed in the policy when you buy it. If you look in the policy you have recently bought, you will probably find that the guaranteed rate at which you can borrow is 5%. If you examine a stock, bond or mutual fund, you will find no such provision.

Yes, the interest rate specified in that "recently bought" policy will be 5%. But that isn't Linton's doing or that of any of his colleagues in the life insurance business. Actually, the majority of the policies in force today call for a guaranteed interest rate of 6%—and that's the way it has been for the past half-century. The only reason Linton's "recently bought" policy reads 5% is that New York state insurance law now prescribes a 5% maximum interest rate on policy loans. The 100 million policies in force today which were written before the New York law became effective all require 6% interest. That's what people have been paying for a half-century during which the despised "stocks, bonds and mutual funds" were being accepted as bank-loan collateral at 3% to 4% interest.

At a meeting of the Investment Analysts Society of Chicago, A. M. Best & Company's vice-president Raymond T. Smith drew attention to the contributions of policy loans in building company profits:

> The industry has no inventory or receivable problems. The former consists entirely of cash and highly liquid assets. As for the latter, if premiums or policy loans are not paid in accordance with provisions, the companies have no alternative except to cancel. Usually, at least on a short term basis, the companies benefit by this necessity.

The Temporary National Economic Committee found during its hearings that

> Policy loans are the highest yield investments of the life insurance companies. There is no other type of investment an insurance company could make which would be as sound.

The committee arrived at that conclusion after hearing testimony like this:

> *Investigator:* So in reality, the return is largest on the safest investment you make?
> *Witness:* This is right.

Should you borrow against your life insurance? The smartest thing, of course, is not to give the company the extra dollars in the first place. If you have already bought cash value insurance, and cannot bring yourself to cancel it, perhaps you should at least pay heed to the advice of the dean of American estate planners, Attorney Rene A. Wormser of New York, who told a meeting of Chartered Life Underwriters in Boston that "more people should borrow the loan value of their life insurance progressively and invest the proceeds in equities as a hedge against inflation."

Needless to say, you should never borrow on your life insurance while at the same time accumulating dividends on a policy.

Chapter 23

Disability and Double Indemnity

TWO EXTRA BENEFITS may be obtained in connection with life insurance: a provision to cover total and permanent disability and a provision covering accidental death.

Where the amount available for the purchase of insurance is limited, view with a jaundiced eye any extra which reduces the amount of protection you are able to buy.

There are two types of disability clause. One provides a waiver of the premium on the policy if the insured becomes totally and permanently disabled (disability is considered "permanent" if it lasts six months). The second disability clause waives the premium and in addition pays an income of $5 or $10 per month per $1000 worth of insurance. Not all companies sell disability income today. No harm done, though. You're better off just buying the waiver-of-premium disability clause. Supplement this with a good health and accident policy with a shorter waiting period than six months.

The disability clause is profitable to the insurance company. In 1960, American life companies collected $155 million in premiums for disability coverage and paid out only $124 million. Table 13 discloses some interesting figures[1] showing what some of the companies took in in premiums and what they paid out.

The disability clause ceases to be effective at age 60, so when you reach that age, make sure that you get a reduction in premium for any policies you've carried which included the disability clause. Don't wait for the company to offer a reduction; it might be overlooked. When you're buying a new policy, read it carefully to be sure that you aren't going to pay for something you don't get. Metropolitan's Young Business and Professional Men's Policy notes that the premium (which is payable annually until age 90) includes the cost of a waiver of premium for disability. Although the benefit expires on the insured's sixtieth birthday, the premium does not then reduce.

[1] Compiled from *Spectator Insurance Year Book (1961).*

TABLE 13

Company	*Disability premiums collected*	*Disability claims paid*	*Amount of Premium Collected for every Dollar of Claims paid*
Acacia Mutual	374,000	122,000	3.06
American General	161,000	12,000	13.41
American National	433,000	89,000	4.85
American United	237,000	108,000	2.14
Bankers Life, Neb.	144,000	27,000	5.33
Bankers National	170,000	51,000	3.33
Bankers Security	20,000	125	160.00
Beneficial Life	77,000	14,000	5.50
Benkshino Life	248,000	63,000	3.93
Business Mens Assur.	545,000	150,000	3.63
Calif.-Western States	821,000	256,000	3.20
Central Life	277,000	112,000	2.47
Central National, Neb.	305,000	53,000	5.75
College Life	875,000	25,000	35.00
Commonwealth Life	392,000	79,000	4.90
Conn. Mutual	1,832,000	890,000	2.05
Credit Life	1,401,000	261,000	5.36
Farm Bureau Life	118,000	5,846	20.18
Fidelity Mutual	670,000	339,000	1.68
Fidelity Union	137,000	4,345	31.53
Franklin Life	1,188,000	127,000	8.35
Gov't Employees Life	50,000	2,789	18.28
Guarantee Mutual	228,000	39,000	5.84
Guardian Life	1,442,000	586,000	2.45
Home Life of N.Y.	1,051,000	251,000	4.14
Kansas City Life	378,000	95,000	3.97
Liberty National	392,000	52,000	7.53
Life Ins. Co. of N. A.	92,000	2,473	37.20
Lincoln National	2,530,000	907,000	2.79
Manhattan Life	544,000	106,000	5.13
Mass. Mutual	3,735,000	1,809,000	2.06
Minnesota Mutual	647,000	237,000	2.73
Monarch Life	272,000	44,000	6.18
Mutual Trust Life	299,000	88,000	3.40
Nat. Life of Vt.	1,261,000	331,000	3.89
Nationwide Life	366,000	12,668	30.50
New England Life	2,071,000	755,000	2.76
N. A. Life & Cas.	186,000	14,000	13.28
Northwestern Mutual	4,291,000	1,064,000	4.03
Occidental, Calif.	3,611,000	727,000	4.97

TABLE 13 (continued)

Company	*Disability premiums collected*	*Disability claims paid*	*Amount of Premium Collected for every Dollar of Claims paid*
Ohio State Life	222,000	38,000	5.84
Pan-American Life	516,000	119,000	4.33
Phoenix Mutual	1,834,000	847,000	2.16
Prudential	34,194,000	20,667,000	1.65
Southern Farm Bureau	165,000	4,393	37.55
Southwestern Life	456,000	191,000	2.38
State Farm Life	400,000	22,000	18.18
United Benefit	731,000	122,000	7.00
United Life & Acc.	140,000	41,000	3.41
U.S. Life	288,000	34,000	8.46
Western Life	200,000	31,000	6.45

Instead, the policyholder is required to continue paying a premium for another 30 years for a nonexistent benefit.

Remember, too, that the companies will not pay claims for disability incurred in the course of military service. If you are called up for military service, notify the company of the fact and ask them to suspend the premium for the disability clause until such time as you become a civilian again.

Don't waste your precious premium dollars buying double indemnity benefits for accidental death. Your family's need for insurance will not be determined by the way in which you die. Why should your family need more insurance if you die in an automobile accident than if you die naturally? There is a good chance that if you are accidentally killed, your family will be able to collect damages and will therefore need less insurance.

The companies make a real killing on the double indemnity clause. In 1960, they took in $155 million in premiums for double indemnity and paid out only $60 million. That's a pretty good margin of profit.

Remember, they don't pay for any accidental death incurred in military service.

Another important point to bear in mind in this airborne age has to do not only with disability and accidental death clauses but with your entire policy. Most companies will pay no disability or accidental death claims resulting from flying.

They will pay the regular insurance if your death occurs while you are riding as a fare-paying passenger on a regular scheduled flight—but not otherwise. So the next time you think of taking one of those $5 sightseeing flights or are invited to ride in someone's private plane, think twice. When you take off, so does your life insurance. If you must ride in a private plane, buy a special policy to cover you against that hazard.

Chapter 24

How to Pay for It

YOU HAVE just signed up for an insurance policy with a premium of $100 per year and the agent suggests that you may wish to pay for it semiannually. To your inquiry as to how much more it will cost that way, he replies, "Only 4%." That seems reasonable and you tell him to put it through on that basis.

"Now, if you'll just let me have your check for the first semiannual premium of $52," he says. You give it to him and he leaves.

Later, you get to thinking about that $52. You'll be paying it twice. That makes $104 per year you'll be paying for a policy which he originally quoted at $100. "Oh, that's where he got the 4%," you think. "He added 4% to the $100 premium."

Come to think of it, though, you didn't owe him $100. You paid him half of it immediately, so you owed him only $52. And in six months, you'll pay him that $52 and then you'll owe him nothing. You start thinking about it.

"Let's see, now—I paid him $4 interest on $52. Why, that's 8% interest, not 4%! Hold on. That was for only six months. And 8% interest for six months is 16% interest per year! Well, I'll be—and he told me it was only 4%!"

That's right—16% "interest" for the privilege of paying your insurance semiannually instead of annually. Do people who pay their insurance semiannually die 16% faster than people who pay it annually? Why should they pay 16% more, then?

If you want to pay the premium quarterly, they add 6% instead of 4%, but because the installments are payable over a different period of time, the effective rate of the extra charge works out to the same 16%.

Many companies are now starting to reduce their charges for semiannual, quarterly, and monthly payments, but 95% of the insurance policies in force in America today are based upon the charges shown here.

Bear in mind that this extra charge is 100% profit to the company. The cash value and reserve on your policy are the same regardless of how you pay your premiums. Of course, the company does have to split with the agent who sweet-talked you into paying this unconscionable extra fee and thereby earned himself 16% effective interest on his deferred commissions. Just how profitable this is can be judged from this statement in the 1961 *Life Insurance Fact Book:*

> A growing percentage of ordinary life purchasers are using monthly premium plans to pay for their protection. More than half of all ordinary policies purchased in 1960 were on a monthly premium basis.

Since 8.7 million ordinary policies were sold in 1960, we must conclude that on the basis of 1960 sales alone, at least 4.4 million Americans are paying through the nose for the privilege of paying premiums monthly.

It is quite unnecessary. If you are buying a $20,000 policy, have the company issue it in four $5000 policies, all on an annual premium basis. Have one due now, the second in three months, the third in six months, the fourth in nine months. Now you will be paying your premiums quarterly but you will be paying the annual premium on a separate policy each time, and you will save the huge extra charge.

If you have an old policy upon which you have been paying premiums quarterly and you cannot get enough together to pay it annually, then take it to your bank and let them finance the annual premium. Then pay the four quarterly premiums to the bank; it will charge you an effective interest rate of 5% on the unpaid balance instead of the 16% which the insurance company has been charging you.

Chapter 25

How to Leave It

A DISMAL STATISTIC supplied by the life insurance companies discloses that 60% of all life insurance payable in cash is dissipated within two years. We all know of instances of widows being separated from the estates left them by their husbands. Compilers of sucker lists offer choice lists of the names of women who have been widowed within the past five years. There are many unscrupulous people who use such lists to find beneficiaries upon whom they can prey.

Not all of the money goes to confidence men. Some is just spent or imprudently invested by beneficiaries ill-equipped to care for large sums of money. Most men display a certain confidence in the good sense of their wives. Too many times it is misplaced confidence. I recall reading of the tragic suicide of a woman whose second husband ascribed her sad end to financial worry. Eleven years earlier, her first husband had died, leaving her fourteen million dollars. Surely he must have had confidence in her to have turned such a huge sum over to her. Alas, instead of financial security, he bequeathed her a headache, a worry, a job for which she was not qualified. Many a man forgets that as his widow grows older, she will be less sharp, less alert to confidence men. Or perhaps he doesn't take into account that the confidence man may be her own son. Precious life insurance proceeds have financed the unsuccessful adventures in business of many a young man whose widowed mother was certain that he could do no wrong.

Our responsibility for providing security for our dependents extends beyond dumping a lot of money in their laps when we die. It includes leaving it in such a fashion that it will provide the continuing financial security they will need, and for as long as they will need it.

Most men leave too little life insurance. Its inadequacy is heightened by the fact that it is not made properly productive for the heirs. As the alternative to leaving insurance to their beneficiaries in cash, they arrange for it to remain with the

insurance company under one or the other of various settlement options which provide for it to be doled out monthly. Meantime, the insurance company puts the money to work, derives a good return, and gives the beneficiary a little bit of interest.

There are four settlement options offered by life insurance companies in connection with payment of the proceeds of your life insurance. They are:

1. The entire proceeds paid in cash in one lump sum
2. The proceeds paid to the beneficiary in installments over a period of years
3. The proceeds used to provide a lifetime annuity income to the beneficiary
4. The proceeds left with the company at interest.

Having concluded that the first option is not desirable for their families, many men enter into a plan involving one or the other, or all three, of the other options. Many insurance men are adept at preparing a chart with colored crayons which illustrates the way in which payment of insurance proceeds may be spread over many years through use of some combination of these options. The drawback to these arrangements is that if you deny the beneficiary the right to draw upon the funds when and as she wishes, you also create an inflexible device to pay out money only in accordance with the precise formula you have set, which does not take into account the changing needs and circumstances of the beneficiary.

The simplest way of overcoming this important disadvantage of inflexibility is through a life insurance trust. The trust is an object of your own creation—you mold it to meet the specific needs of your family.

There are two basic ways of setting up a life insurance trust. The first is to create the trust immediately and make it the beneficiary of your life insurance policies. The trust goes into operation as soon as it receives the proceeds of your life insurance after your death. You can "fund" the trust—that is, you can transfer income-producing property to it, the income to be used to pay the premiums on your policies.

The second way to set up a life insurance trust is by will. Here your estate becomes the beneficiary of the policy. The estate turns the proceeds over to the trust. This plan has important drawbacks. First, if the probate of your will is delayed, so is the operation of the trust. Second, most states tax

proceeds of life insurance payable to an estate while exempting at least some portion of proceeds payable to a named beneficiary. Third, probate is something to be avoided wherever possible. Attorney, executor, appraiser, and probate court fees can run up to 10% or more. Therefore, don't subject any of your property to probate if you can avoid it.

Whichever type of life insurance trust you decide upon, you will have broad freedom of action. You may choose a trustee whom you know to be qualified to carry out your instructions. This can be an individual but you should consider that individuals can be away, busy, or ill, and can even die. You'd be better advised to appoint a corporate trustee—your local bank or trust company.

In the trust instrument, you can direct specifically how you want the money to be paid out. Be careful, though. Don't authorize an income of *x* dollars per month. A few years hence, inflation may make that income inadequate. Relate the income to the amount of principal; if you must be specific, say that the income "shall be not less than." Years ago, Charles Hayden died and left $55 million, specifying that the beneficiaries were to be paid 6% good years and bad. Gains above that were to be plowed back into the trust in the good years, and could be drawn upon to make up the income deficit during lean years. Many men now use this pattern to provide trust income.

Above all, take advantage of the greatest benefit of the life insurance trust—the opportunity to give the trustee discretion to vary payments in accordance with the needs of your heirs. If you tell an insurance company to pay the proceeds in equal shares to your two daughters, they'll carry out your instructions to the letter. But suppose one of your daughters marries the wealthiest man in town while the other becomes an invalid and spends her life in a wheelchair. It doesn't make sense for the income from your estate to be paid to them equally. *You* wouldn't do it that way if you were here making the distribution yourself. So give your trustee discretionary power to sprinkle the income where it will do the most good. That's what a trustee is for, to exercise judgment in the application of money to family needs.

Finally, with a trust you can direct how the money shall be invested. Preferably, give the trustee instructions; at the very least, give guidance. Coming into widespread use is a form of trust developed some years ago which the technical

publications in the trust field now graciously designate as a "Dacey trust." Under it, one's lifetime accumulation of mutual-fund shares plus the proceeds of one's life insurance are both made payable to a local bank at death. The residue of one's estate also passes into the trust at death by testamentary disposition in the will. The local bank thereafter is bookkeeper, watchdog, and disbursing agent. The investment of the combined trust is under the continuing supervision of the mutual fund, however. This arrangement is for a person who has carefully selected a mutual-fund management to handle his whole estate during his lifetime and who has been satisfied with the mutual fund's management. He wishes his family to enjoy the services of the same management which he has had an opportunity to observe in action during his lifetime and which he confidently expects will continue to do the same sort of job for his heirs.

In most instances, the management provided by the mutual fund will be superior to that provided by the local bank. Sometimes provincial bankers will suggest that if their bank is good enough to be trustee, it is good enough to manage the money. Reject this view. If they persist, find another trustee.

Whichever management you elect for your life insurance trust, the living trust arrangement will be a vast improvement over the settlement options available under your insurance policy.

Many men have elected to leave the proceeds of their life insurance with the insurance company at interest subject to withdrawal by their wives. By thus giving their spouses the right to take the money, they quite naturally assumed that their estates would qualify for the marital deduction which would mean that half would be tax-free at their death.

Unfortunately, such was not the case. Insurance companies impose various restrictions on the withdrawal of funds left at interest—small, petty things but enough to constitute a legal restriction upon the widow. For example, the company might restrict withdrawal by the widow to specific times, such as the regular interest dates. It might require notice of such intended withdrawals—perhaps 30 or 60 days. It may prohibit any withdrawals until at least 30 days after the receipt of proof of death. It may require that withdrawals be not less than a specified amount, such as $50 or $100. None of these restrictions seems important and yet there have been instances of courts' deciding that the marital deduction was forfeited

simply because the insurance policy contained one or more of these seemingly harmless clauses.

Anyone whose estate is in a bracket high enough for death taxes to be a factor and who has elected the interest option for his spouse should take careful note that he has placed his estate in tax jeopardy.

Speaking of taxes, if your estate is large enough to create a tax problem, you should give serious thought to making your spouse the absolute owner of at least a portion of your life insurance, thus exempting it from federal estate tax at your death. Your wife can enter into a trust agreement with your local bank under the terms of which the bank's only job is to collect on the life insurance policies on your life of which she is the owner and deposit the proceeds in the trust which you yourself had set up in the same bank. Your estate ends up in one neat package but you've avoided some taxes. This arrangement works best with new policies. Consider carefully the possible gift-tax liability in assigning your spouse an existing policy with a cash value.

The dollars-and-cents advantages of a life insurance trust over settlement options are clearly shown in Table 14, which illustrates two methods of distributing life insurance proceeds: (1) under the most popular life insurance company settlement option and (2) under the insurance trust.

TABLE 14

COMPARISON OF TWO METHODS OF DISTRIBUTING $100,000 LIFE INSURANCE PROCEEDS TO A WIDOW AGE 40

1. Under the most popular life insurance settlement option. (Payments for 20 years certain and thereafter for lifetime of primary beneficiary.)		2. Under life insurance trust.	
GUARANTEED ANNUAL DISTRIBUTION FROM PRINCIPAL AND INCOME (No withdrawals from principal permitted regardless of emergency needs.)	$ 4,044	ANNUAL NET INCOME @ 4% (Income not guaranteed. Trust is flexible to meet changing needs and emergencies.)	$ 4,000
TOTAL DISTRIBUTION OF INCOME AND PRINCIPAL FOR 20 YEARS (Of this amount $70,240 is excludable from income tax.)	$80,880	TOTAL INCOME FOR 20 YEARS (This income is subject to Federal income tax.)	$ 80,000
PRINCIPAL REMAINING FOR CHILDREN AT END OF 20 YEARS	NONE	PRINCIPAL REMAINING FOR CHILDREN AT END OF 20 YEARS	$100,000*

* Principal invested in all stock and balanced mutual funds for past 20 years showed average appreciation of 125%. At a possible sacrifice of $880 income during the 20 years, there is a possible gain of $100,000 through use of the insurance trust for widow and children instead of insurance settlement option.

Chapter 26

Buy Term and Invest the Difference

A PAST PRESIDENT of the American Society of Actuaries and of a life insurance company, M. Albert Linton, has written at length on the subject of life insurance as an investment.

Armed with an ordinary life policy issued at age 35, a slide rule, and a set of interest tables, Linton went Moses-like up on his actuarial mountain and came down bearing a tablet upon which was carved the message that life insurance is the greatest investment in the world. In the fine carving at the bottom of the tablet, it was recorded that to equal the cash value of that ordinary life policy issued at age 35 which Linton took aloft with him, a separate investment fund would have to yield a net compound interest return of 4.59%, after all expenses and taxes.

Word of the message on the tablet spread like wildfire. Insurance men were dancing in the streets. If you asked one of them how in the world Linton was able to figure out how a life insurance policy guaranteeing 3% per year on its reserve could outperform an investment paying 4½% net after taxes, he might just gurgle happily, " I don't *know* how he figured it! All I know is he *did*! Wheee-ee-ee!" and run down the street before you could question him further.

The Life Insurance Agency Management Association, in its paean *What You Should Know About Permanent Life Insurance*, hailed the tablet's message in these words: "One cannot buy term insurance separately and come out very well investing the difference elsewhere. . . . The unique advantages of permanent life insurance simply cannot be duplicated."

Now, that's pretty unequivocal, isn't it? "One cannot buy term insurance separately and come out very well investing the difference elsewhere."

This is very puzzling because elsewhere in this same flight of fancy, in a chapter headed "Tax Aspects," the LIAMA makes the point that life insurance has a lot of wonderful tax benefits. It says: "For most ordinary life policies, little or no taxable gain would arise upon surrender at age 65." No gain at all at 65? After owning this wonderful investment that Linton told us about and paying premiums on it all the

years from age 30 or 35 or 40? *No* gain? But Linton said . . . well, let it go.

In support of its contention that life insurance is an investment, the same booklet, under a heading "Opportunity for Appreciation," recites that:

> From an investment viewpoint, the maturity of a life insurance contract by death normally provides substantial immediate appreciation in value for the insured's heirs. Moreover, this appreciation is free of income tax.

It is preposterous to call this thing an "investment" and to speak of an "opportunity for appreciation" by reason of the death of the policyholder. If the insured dies, the appreciation to which they refer comes 100% from the reducing term insurance element in the policy—and not one iota from the cash value. If the arbitrary assumption of premature death is valid (and of course, it isn't), then the greatest appreciation would come from a policy of pure protection, and the least appreciation would come from a higher-premium "permanent" plan.

As for it being "free of income tax," this is deliberately intended to mislead—*no* property is subject to income tax at death. These people are hoping that the unwary reader will misunderstand it to mean that there are no death taxes on life insurance, when in fact it is taxed just like any other property for estate-tax purposes.

It is relatively easy to juggle the "return" on the savings or investment element in "permanent" insurance. All one needs to do is overstate the cost of term insurance. For example, let's assume a $500 annual premium on a savings-protection policy and a $10,000 cash value in 20 years. If we arbitrarily assign $200 as the cost of term insurance, we have $300 left over for the savings element. If the $300 per year grows to $10,000 in 20 years, we must have a fairly high annual return—over 5%.

On the other hand, if we assign $100 as the cost of the term insurance, we have $400 left over for the savings element. If the $400 per year grows to $10,000 in 20 years, we have a lower annual rate of return—actually, less than 2½%. This rather simple manipulation creates a difference in excess of 100%!

In considering the claimed advantages of life insurance as

an investment and comparing these with alternative plans for accumulating an estate, one should first fix in one's mind the definition of an investment.

When you invest money, you get *earnings*. When you lend money, you get *interest*. Thus, since an insurance company pays you a fixed rate of interest for the use of your money, the transaction qualifies as a loan rather than as an investment.

Insurance men ask: "What return can you expect on investments which are similar to the savings element in life insurance?"

The question is immaterial. If the savings element in life insurance does not permit you to reach your investment goal, the return on similar investments is of little significance. The real question is: "What return can you expect on an investment that substantially fulfills your objectives?"

Let us therefore compare cash value life insurance with the alternatives available to us. We will ignore the fact that the average life of an insurance policy is 7 years and that more than 18 million policies are being lapsed or surrendered this very year. We will not labor the point that these policies are obviously not fulfilling the objective of building long-term security for their owners. We will ignore, too, the fact that the life insurance way of building an estate robs saving of all incentive. Each dollar of savings made outside the insurance estate increases our estate by a corresponding amount, while each dollar saved within the policy is lost at death. By separating the protection account from the savings account, our estate gains without a cent of additional expenditure. With cash value insurance there is no incentive to save faster —you would simply be building the cash value and thus reducing the insurance company's liability faster.

How much can one reasonably expect to earn if one buys term insurance and invests the difference? In a savings account or in U.S. savings bonds, one can easily obtain 3¾%. This doesn't qualify as an investment by our definition; rather it is a loan—we have lent our money to the bank or to the government. It is a riskless "investment" in terms of the safety of our dollars. In an earlier chapter discussing the inroads of inflation upon cash value life insurance, we observed that safety does not necessarily result from hoarding dollars.

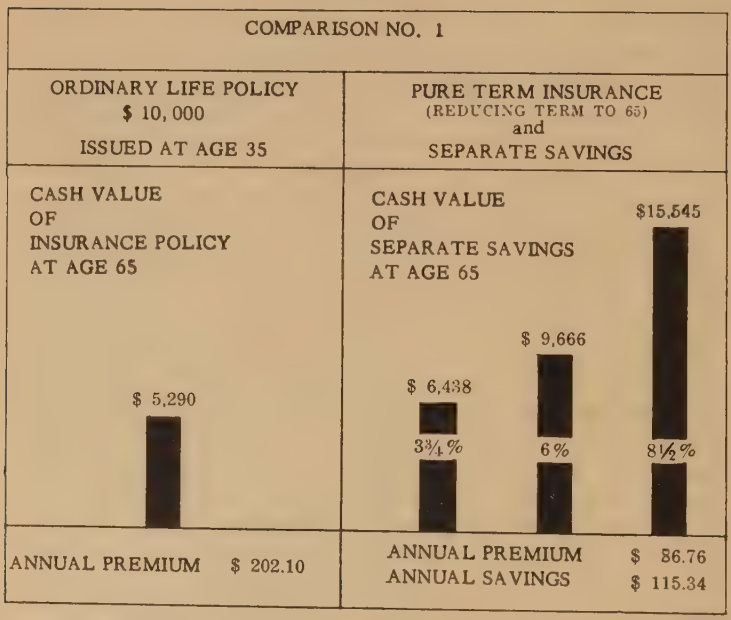
Many people assume a return of 6%. Most mortgages issued today bear this rate of interest. Many trust instruments

provide that an annual distribution of 6% shall be paid to beneficiaries.

A number of studies of the results of common stock investing have been made over the years by competent organizations. One of them, surveying the trend of stock earnings and prices over the years, concluded that between annual dividends and average annual appreciation in price, the total over-all gain averaged out to approximately 8½% per year over all the years since 1870.

Let us therefore now scrutinize searchingly the investment characteristics of the principal types of cash value life insurance policies and note how profitable they are by age 65, the

CHART 8

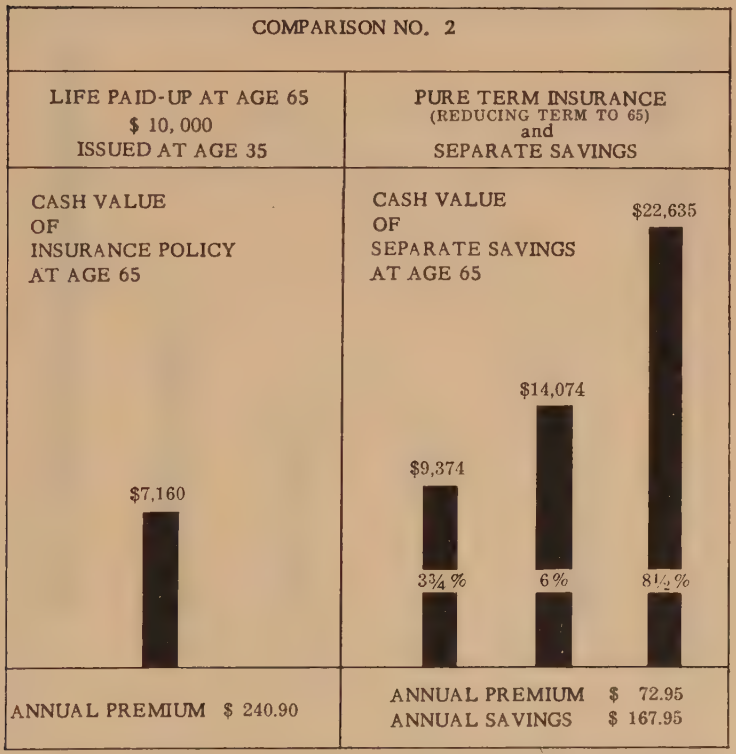


The ordinary life, or whole life, policy is the least expensive of the many various types of cash value policies. This is because premiums are payable to age 100, at which time the cash value equals the original face amount of the policy and the insurance terminates.

Like all cash value policies, it is a combination of reducing term insurance and savings. As the savings increase, the insurance at risk automatically reduces. The advantage of using pure term insurance and separate savings is shown.

time when even the insurance men admit we are likely to be more concerned about having a fund for retirement than about protecting families then grown. Then let us compare the investment results of each of these policies with those which would obtain if we were to "buy reducing term insurance and invest the difference" at 3¾%, 6%, and 8½%.

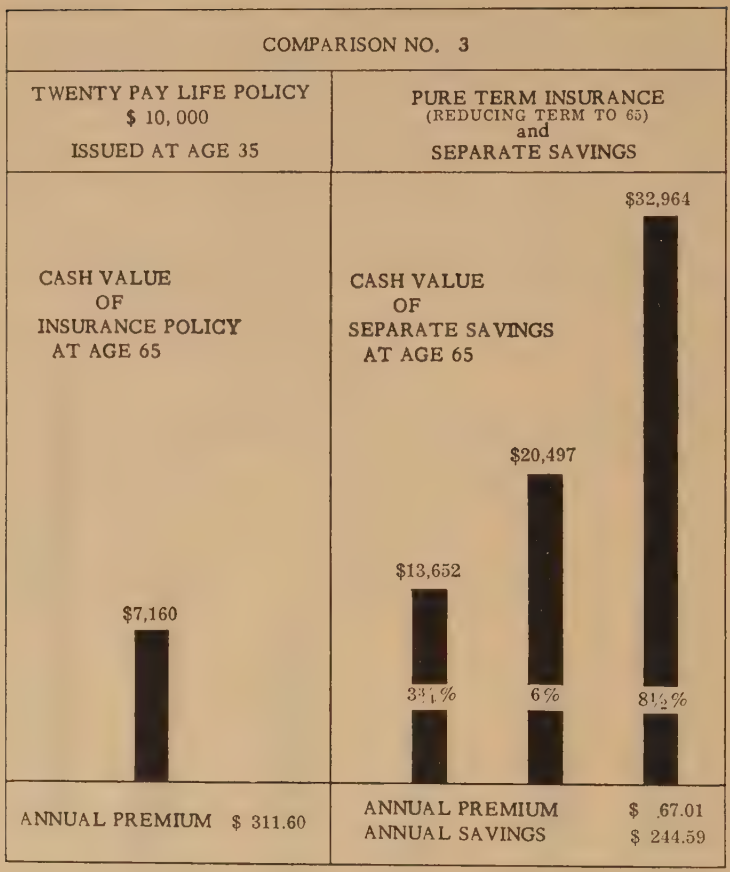
CHART 9



The life paid-up-at-age-65 policy is a variation of ordinary life. Premiums are higher, as they are payable only to age 65—in this example for 30 years—at which time the policy becomes paid up. (*Paid up* means that the company earnings on the cash value of $7160 are sufficient to carry the reducing insurance to maturity at age 100.)

The insurance at risk at age 65 has reduced to $2840—the difference between the face amount of the policy and the cash value at that age. The advantage of using term insurance and separate savings is quite apparent.

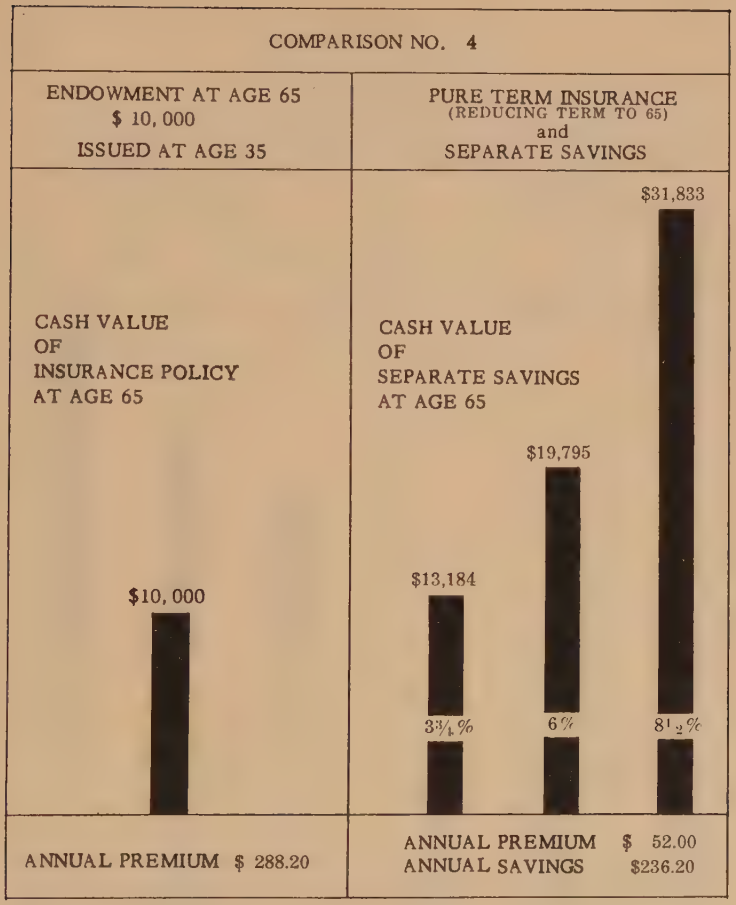
CHART 10



The twenty-pay life policy is another variation of ordinary life. Premiums are higher as they are payable for only 20 years, at which time the policy becomes paid up. (*Paid up* means that the company earnings on the cash value of $7160 are sufficient to carry the reducing amount of insurance to maturity at age 100.)

The insurance at risk at age 65 has reduced to $2840, the difference between the face amount of the policy and the cash value at that age. The advantage of using term insurance and separate savings is readily apparent.

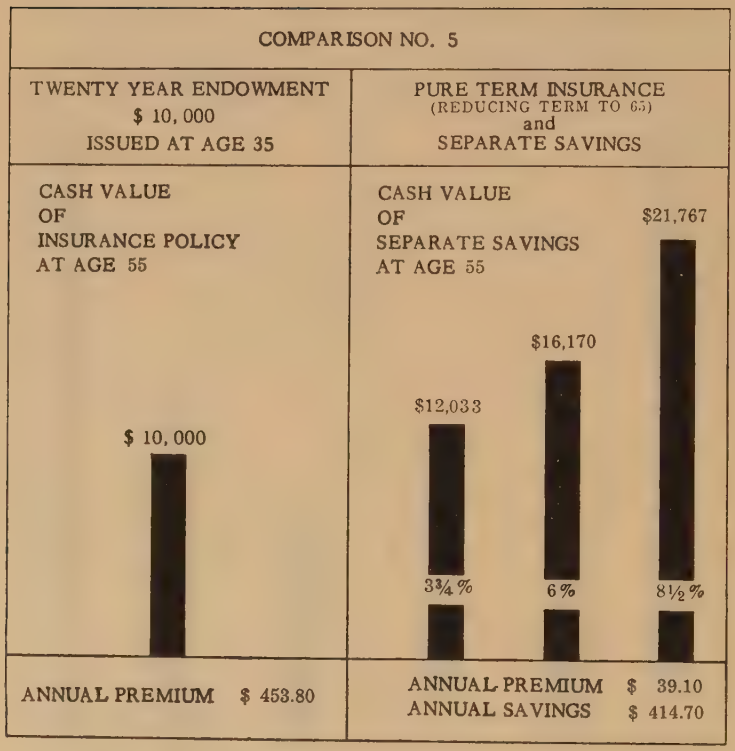
CHART 11



Endowment policies are a combination of reducing term insurance and increasing savings. In the above example the insurance at risk reduces rapidly—from $10,000 at age 35 to zero at age 65. Premiums are payable for 30 years.

The premium for equivalent reducing term insurance is only $52, leaving $236.20 per year for separate investing. This sum invested separately will grow much faster independent of the insurance. The chart illustrates the great difference to be gained.

CHART 12



The twenty-year endowment policy illustrated above is another high-priced combination of reducing term insurance and increasing savings. Premiums are payable for 20 years, at which time the policy endows—that is, the cash value equals the face amount of the policy and the contract matures.

Comparable term insurance is available for less than 10% of the endowment premium. The difference in premiums invested separately will grow much faster independent of the insurance. The chart illustrates the advantage to be gained.

CHART 13

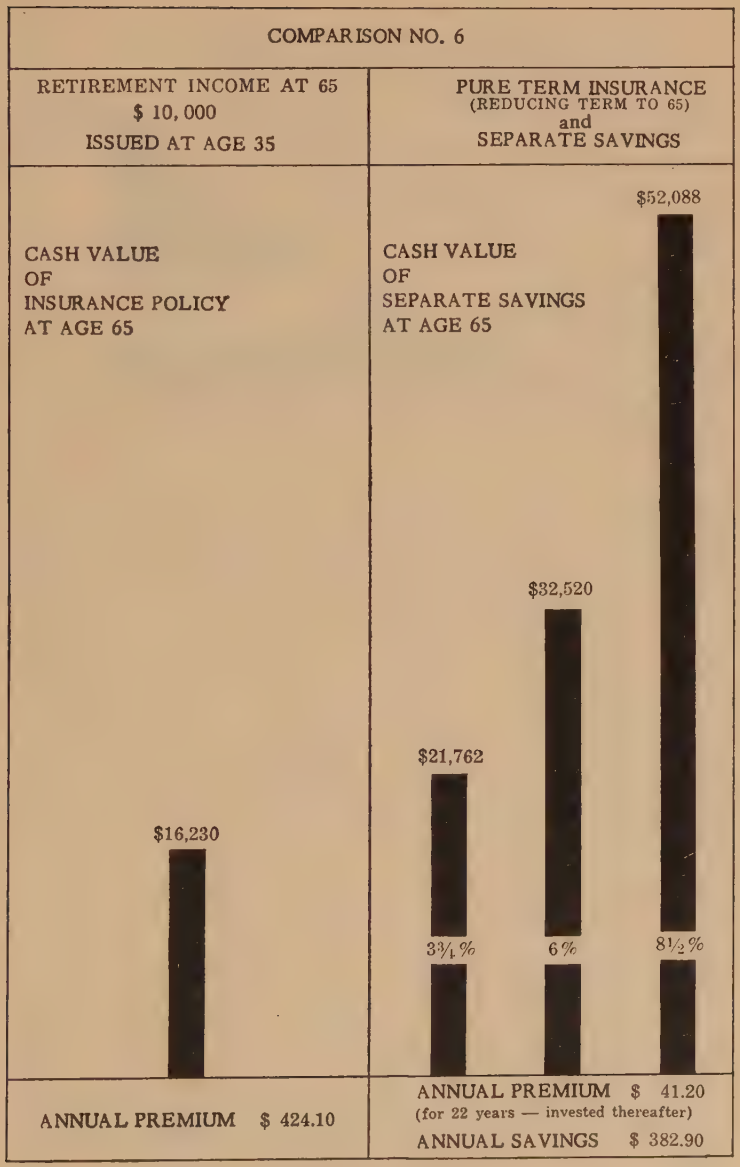
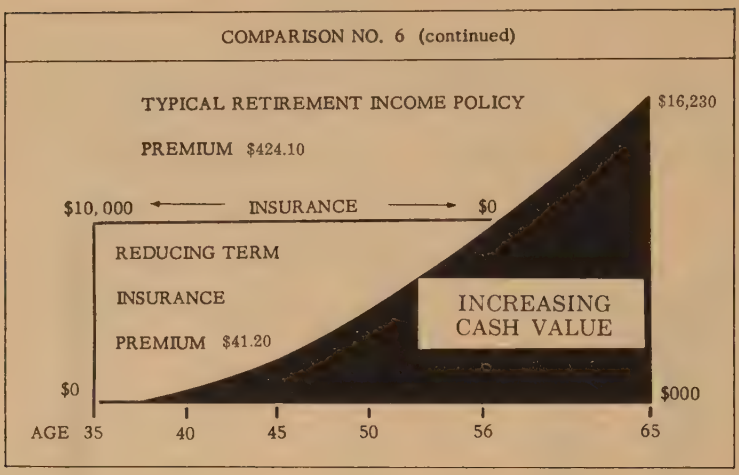

COMPARISON NO. 6
RETIREMENT INCOME AT 65
$ 10,000
ISSUED AT AGE 35
PURE TERM INSURANCE
(REDUCING TERM TO 65)
and
SEPARATE SAVINGS
CASH VALUE
OF
INSURANCE POLICY
AT AGE 65
$16,230
CASH VALUE
OF
SEPARATE SAVINGS
AT AGE 65
$21,762
$32,520
$52,088
3¼%
6%
8½%
ANNUAL PREMIUM $ 424.10
ANNUAL PREMIUM $ 41.20
(for 22 years — invested thereafter)
ANNUAL SAVINGS $ 382.90

CHART 13 (continued)



The retirement income policy illustrated is typical of all retirement income contracts. These policies emphasize high cash values and guaranteed annuity features. They are known by a variety of names, including endowment income, retirement endowment, income at age 65, and living insurance.

All are combinations of rapidly reducing term insurance and a yearly investment of an amount that will accumulate to a definite sum at a definite time—usually at age 55, 60, or 65. The sum to be accumulated is the price of an annuity at the age specified.

In this example the sum is $16,230, which is the amount required to provide a life income of $100 a month at age 65. The amount varies slightly with different insurance companies and is higher for women.

ANALYSIS FROM THE BUYER'S POINT OF VIEW

1. *As an insurance policy.* Equivalent insurance protection is available at a cost of only $41.20 a year and this amount need be paid for only 22 years.

2. *As an investment.* Separate investment of the premium savings, at only 3¾%, will accumulate to $21,762 in the same period—a gain of $5532.

3. *As a retirement annuity.* The policy provides $100 a month life income with 10 years certain. The $21,762 accumulated separately will purchase an identical annuity paying $141.50 a month for life—and need not be contracted for years in advance.

Chapter 27

Term Insurance Plus Mutual Funds

RECENTLY I WAS called upon to advise on the desirability of the purchase of a $30,000 nonparticipating endowment-at-65 policy by a man now age 40. The premium was $1081.91 per year, a total of $27,048.75 at age 65, when the policy would mature for its $30,000 face amount.

I established that the level-premium rate for $30,000 of reducing term to 65 was $168.84 per year. This left a difference of $913.07 per year which could be invested separately.

Next, I obtained the performance records of two leading mutual investment funds, Wellington Fund (a large and well-known balanced investment fund with a conservative policy of investment in bonds and preferred and common stocks) and Fundamental Investors (also large and well known as a blue-chip common stock fund seeking income and long-term capital growth). Both funds have been in existence more than 25 years. I assumed that the client for whom I was making the study had faced the problem 25 years ago and that he elected to buy the reducing term insurance and invest the difference in one or the other of these two funds.

As investments, life insurance and mutual funds are quite dissimilar, of course, although both fluctuate. Life insurance fluctuates in purchasing power; mutual funds fluctuate in dollars. In an earlier chapter we discussed the disastrous effect of inflation on life insurance and concluded that there was great risk, if not likelihood, of loss. With mutual funds, as with all investments, there is also risk of loss, although this is reduced through wide diversification and continuing professional investment supervision.

Bearing in mind the results of the Linton research on behalf of cash value insurance and the Life Insurance Agency Management Association's statement that "one cannot buy term insurance separately and come out very well investing the difference elsewhere," I invite you to examine the actual results of such a course of action over the past 25 years as illustrated in Tables 15 and 16.

TABLE 15

ILLUSTRATION OF ASSUMED ANNUAL INVESTMENTS OF $913.07 IN WELLINGTON FUND SHARES

All Dividends and Distributions Reinvested
Twenty-five Year Example, 1937–1961

This tabulation covers an illustration of an assumed investment of $913.07 annually on January 1 of each year from 1937 through 1961. This was a period in which stock prices fluctuated widely because of changing business and economic conditions, and were somewhat higher at the end of the period than at the beginning. Thus, these results should not be considered as a representation of the dividend income or capital gain or loss that may be realized from an investment made in the Fund today. A program of the type illustrated does not assure a profit nor protect against depreciation in declining markets.

	COST OF SHARES					*VALUE OF SHARES*				*DEATH ESTATE*	
Year Ending Dec. 31	*Cumulative Annual Investments*	*Annual Income Dividends Reinvested*	*Cumulative Cost of Shares Purchased with Dividends*	*TOTAL COST (Includes Reinvested Dividends)*	*Acquired Through Annual Investments*	*Accepted as Capital Gain Distributions (Cumulative)*	*SUB-TOTAL*	*Purchased Through Reinvestment of Income (Cum.)*	*TOTAL VALUE*	*Proceeds of Term Insurance Purchased Separately*	*Total Death Estate Including Term Insurance and Mutual Fund Shares*
1937	$ 913.07	$ 32	$ 32	$ 945	$ 500	$ 17	$ 517	$ 23	$ 540	$ 30,000	$ 30,540
1938	1,826.14	64	96	1,922	1,503	36	1,539	100	1,639	29,178	30,817
1939	2,739.21	66	162	2,901	2,415	142	2,557	172	2,729	28,331	31,060
1940	3,652.28	117	279	3,931	3,065	225	3,290	279	3,569	27,455	31,024
1941	4,565.35	224	503	5,068	3,517	256	3,773	459	4,232	26,564	30,796
1942	4,578.42	270	773	5,351	4,748	366	5,114	795	5,909	25,632	31,541
1943	6,391.49	315	1,088	7,479	6,551	625	7,176	1,245	8,421	24,685	33,106

1944	7,304.56	355	1,443	8,748	8,252	1,040	9,292	1,757	11,049	23,696	34,745
1945	8,217.63	358	1,801	10,019	10,373	1,877	12,250	2,383	14,633	22,679	37,312
1946	9,130.70	384	2,185	11,316	10,224	2,338	12,562	2,540	15,102	21,647	36,749
1947	10,043.77	516	2,701	12,745	10.079	2,496	12,575	2,811	15,386	20,573	35,959
1948	10,956.84	645	3,346	14,303	10,679	2,789	13,468	3,382	16,850	19,457	36,300
1949	11,869.91	862	4,208	16,078	12,660	3,316	15,976	4,629	20,605	18,327	38,932
1950	12,782.98	974	5,182	17,965	14,341	3,906	18,247	5,933	24,180	17,154	41,334
1951	13,696.05	1,071	6,253	19,949	15,976	4,798	20,774	7,335	28,109	15,939	44,048
1952	14,609.12	1,176	7,429	22,038	17,535	5,756	23,291	8,850	32,141	14,695	46,836
1953	15,522.19	1,283	8,712	24,234	17,580	6,256	23,836	9,765	33,601	13,409	47,010
1954	16,435.26	1,433	10,145	26,580	22,676	8,849	31,525	13,590	45,115	12,095	57,210
1955	17,348.33	1,646	11,791	29,139	25,444	11,266	36,710	16,382	53,092	10,738	63,830
1956	18,261.40	1,825	13,616	31,877	25,650	12,878	38,528	17,750	56,278	9,340	65,618
1957	19,174.47	2,050	15,666	34,840	23,571	13,397	36,968	17,694	54,662	7,884	62,546
1958	20,087.54	2,190	17,856	37,944	29,307	18,366	47,673	24,625	71,298	6,400	77,698
1959	21,000.61	2,420	20,276	41,277	30,731	21,290	52,021	26,505	78,526	3,292	81,818
1960	21,913.68	2,669	22,945	44,859	30,988	23,755	54,743	28,727	83,470	1,667	95,137
1961	22,826.75	2,885	25,830	48,657	35,584	29,682	65,266	35,022	100,288	0	100,288

The total cost figures represent the annual investments of $913.07 (including a sales charge of 8% on shares so purchased as described in the prospectus) plus the cumulative amount of income dividends reinvested without sales charges. No adjustment has been made for any income taxes payable by shareholders on capital gains distributions and income dividends reinvested in shares. The dollar amounts of capital gains distributions accepted in shares annually from 1937 through 1961 were: $21, $16, $98, $85, $54, $86, $201, $339, $683, $641, $375, $351, $248, $371, $677, $744, $749, $1,116, $1,682, $1,867, $1,939, $2,218, $2,553, $2,757, $3,163. Total: $23,084.

TABLE 16

ILLUSTRATION OF ASSUMED ANNUAL INVESTMENTS OF $913.07 IN FUNDAMENTAL INVESTORS SHARES

All Dividends and Distributions Reinvested
Twenty-five Year Example, 1937–1961

This tabulation covers an illustration of an assumed investment of $913.07 annually on January 1 of each year from 1937 through 1961. This was a period in which stock prices fluctuated widely because of changing business and economic conditions, and were somewhat higher at the end of the period than at the beginning. Thus, these results should not be considered as a representation of the dividend income or capital gain or loss that may be realized from an investment made in the Fund today. A program of the type illustrated does not assure a profit nor protect against depreciation in declining markets.

	COST OF SHARES					*VALUE OF SHARES*				*DEATH ESTATE*	
Year Ending Dec. 31	*Cumulative Annual Investments*	*Annual Income Dividends Reinvested*	*Cumulative Cost of Shares Purchased with Dividends*	*TOTAL COST (Includes Reinvested Dividends)*	*Acquired Through Annual Investments*	*Accepted as Capital Gain Distributions (Cumulative)*	*SUB-TOTAL*	*Purchased Through Reinvestment of Income (Cum.)*	*TOTAL VALUE*	*Proceeds of Term Insurance Purchased Separately*	*Total Death Estate Including Term Insurance and Mutual Fund Shares*
1937	$ 913	$ 26	$ 26	$ 939	$ 522	$ 16	$ 538	$ 16	$ 554	$ 30,000	$ 30,554
1938	1,826	34	60	1,886	1,761	19	1,780	59	1,839	29,178	30,917
1939	2,739	78	138	2,877	2,401	37	2,438	129	2,567	28,331	30,898
1940	3,652	127	265	3,917	2,830	33	2,863	232	3,095	27,455	30,550
1941	4,565	225	490	5,055	3,200	28	3,228	397	3,625	26,564	30,189
1942	5,478	269	759	6,237	4,805	66	4,871	746	5,617	25,632	31,249
1943	6,391	255	1,014	7,405	7,306	150	7,456	1,202	8,658	24,685	33,343

1944	7,304	308	1,322	8,626	9,646	407	10,053	1,726	11,779	23,696	35,475
1945	8,217	354	1,676	9,893	14,209	1,316	15,525	2,717	18,242	22,679	40,921
1946	9,130	299	1,975	11,105	12,721	2,107	14,828	2,528	17,356	21,647	39,003
1947	10,043	642	2,617	12,660	13,068	2,253	15,321	3,034	18,355	20,573	38,928
1948	10,956	1,006	3,623	14,579	13,400	2,232	15,632	3,811	19,443	19,457	38,900
1949	11,869	1,061	4,684	16,553	16,120	2,663	18,783	5,388	24,171	18,327	42,498
1950	12,782	1,447	6,131	18,913	20,040	3,631	23,671	7,756	31,427	17,154	48,581
1951	13,695	1,766	7,897	21,592	23,116	5,027	28,143	10,222	38,365	15,939	54,304
1952	14,608	1,834	9,731	24,339	25,208	6,251	31,459	12,482	43,941	14,695	57,636
1953	15,521	2,012	11,743	27,264	24,070	5,966	30,036	13,409	43,445	13,409	56,854
1954	16,434	2,197	13,940	30,374	35,327	10,805	46,132	21,372	67,504	12,095	89,599
1955	17,347	2,511	16,451	33,798	43,509	13,000	56,509	28,170	84,679	10,738	95,417
1956	18,260	2,820	19,271	37,531	46,911	17,229	64,140	32,413	96,553	9,340	105,893
1957	19,173	3,127	22,398	41,571	38,084	16,640	54,724	28,444	83,168	7,884	91,052
1958	20,086	3,018	25,416	45,502	53,107	25,330	78,437	42,096	120,533	6,400	126,933
1959	20,999	3,083	28,499	49,498	57,313	29,693	87,006	47,598	134,604	3,292	137,896
1960	21,912	3,250	31,749	53,661	54,114	30,724	84,838	47,349	132,187	1,667	133,854
1961	22,825	3,527	35,276	58,101	65,645	41,776	107,421	59,894	167,315	0	167,315

The total cost figures represent the cumulative total of yearly investments of $913.07 plus the cumulative amount of income dividends reinvested, and includes the sales charge of 8¾% on all shares so purchased, as described in the prospectus. No adjustment has been made for any income taxes payable by shareholders on security distributions and dividends reinvested in shares. The dollar amounts of security profits distributions taken in shares were: 1937—$20, 1938—None, 1939—$23, 1940-41—None, 1942—$37, 1943—$76, 1944—$271, 1945—$924, 1946—$1,101, 1947—$267, 1948—$71, 1949—$160, 1950—$527, 1951—$1,091, 1952—$1,038, 1953—$226, 1954—$2,465, 1955—None, 1956—$3,429, 1957—$3,821, 1958—$2,064, 1959—$2,830, 1960—$3,570, 1961—$4,554. Total: $28,565.

Where hindsight is concerned, we all have 20–20 vision. Were we to select two individual securities which had done well over the past 25 years and compare them with a life insurance policy's results over the same period, the study would be meaningless. Who could say that we would have chosen to invest in the two winners? The use of a mutual fund as the yardstick is a different matter, though. The results were not dependent upon the successful performance of any one security. Mutual funds have widely diversified portfolios under continuous professional supervision. We observed earlier that these are the very advantages the life insurance companies hold out to us as reasons we should "invest" in life insurance. The principles are undeniably sound.

The selection of these two funds for the purposes of this illustration was influenced by the fact that between them they have approximately 200 insurance companies among their shareholders. It is quite likely that a growth mutual fund would have produced more spectacular results.

Bearing in mind that the purpose of life insurance is to provide protection, do not fail to note the enormous difference in the death benefit provided by the buy-term-and-invest-the-difference method. So much for the claim of the life insurance industry that "one cannot buy term insurance and come out very well investing the difference elsewhere."

Worth investigating are the opportunities available for investment in mutual funds. Nearly all of them provide periodic investment programs. Many of these include an arrangement under which you are sent a reminder notice when a payment is due. Those people who feel the need for the compulsion of a premium notice to encourage regular saving will find its equivalent here. Many of these investment programs contemplate accumulation over a period of 10 or 15 years and provide special low-cost reducing term insurance automatically guaranteeing the immediate completion of the program in the event of death during that period. Some include disability coverage equivalent to that provided by a life insurance policy. Such plans do not guarantee a profit nor assure against depreciation in declining markets.

Please understand: *no mutual fund is a substitute for life insurance*. The life insurance protection afforded by these plans is merely to assure the plan's completion. A man who can put aside $100 monthly needs more than the $12,000 of life insurance which the mutual fund plan will provide on a

10-year accumulation basis or the $18,000 provided on a 15-year accumulation basis.

The mutual fund in which you invest should be chosen very carefully, having in mind the importance of balance in an estate. Many people think that "investment" means buying common stocks. This is amateurish. Investment involves balance. If you took $10 million to the trust department of a big-city bank and directed it to invest the money for you, the bank would "balance" it—you'd own bonds *and* preferred stocks *and* common stocks. The Rockefeller, Carnegie, Ford, Guggenheim and other great endowed foundations follow a policy of balanced investment. College and university endowment funds are all balanced.

This book is about insurance, not about investment. I offer this brief comment only because we have examined life insurance as an investment and have compared it with other methods of accumulation. I am not saying that you should put all of your money into common stocks as insurance advocates of the variable annuity would have you do. You should first buy life insurance for protection. Next, you should accumulate an emergency fund. Only then should you begin thinking of investment. Invest cautiously; let your first objective be not to lose what you already have.

Don't be an extremist. Neither hoard dollars via life insurance nor be a plunger in the market. Be a middle-of-the-roader.

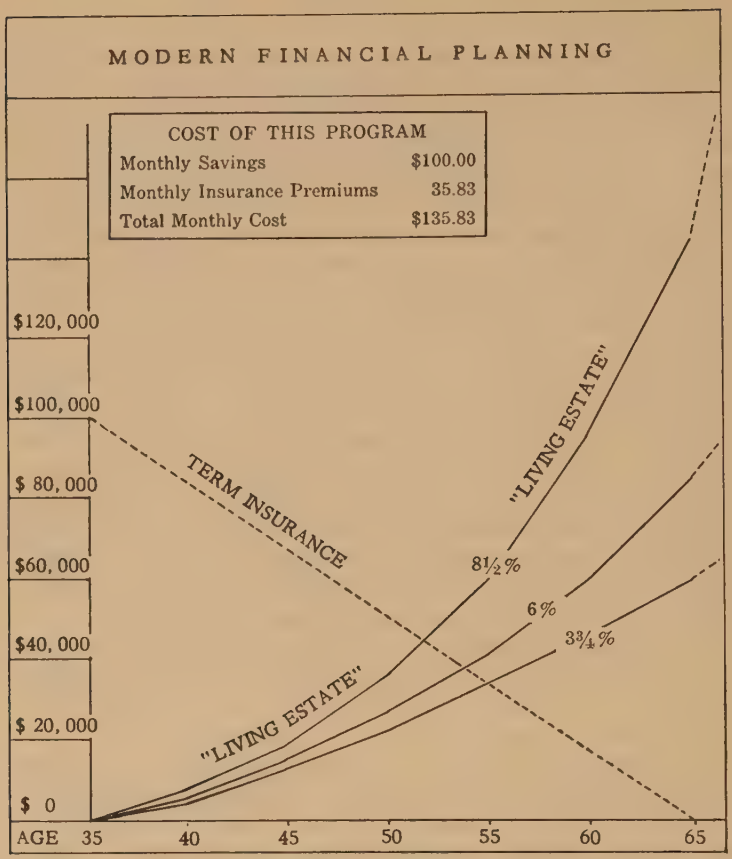
The word is *balance*.

All of this is predicated upon the assumption that you have the intestinal fortitude to accumulate on your own. If you're a financial jellyfish who just can't save any money unless an insurance company takes it away from you, then you'd better just stick with the high-cash-value insurance. They'll take it away from you. Realize, though, that you are paying a high price for your weakness.

The enormous accumulation of money in savings banks, savings and loan associations, postal savings, and U.S. savings bonds suggests that you *are* able to accumulate on your own.

In that case, you'll be much better off if you buy term and invest the difference.

CHART 14



Modern financial planning is a practical, efficient solution to the following two questions:

What will happen to my family—if I die?
What will happen to me—if I live?

The dotted line above shows the insurance protection provided for the family at the low cost of $35.83 a month. The initial protection is $100,000, reducing to $0 at age 65.

The three solid lines illustrate the accumulating value of separate savings of $100 a month, invested to compound at the rates shown.

To duplicate the insurance protection and to accumulate $100,000 in cash values by age 65 through insurance alone would require monthly premiums of $232.67 (endowment at 65).

Chapter 28

Regulation

PRACTICALLY EVERY industry in America is regulated to some degree, including some whose activities touch only a small segment of our population. The life insurance colossus, whose product constitutes an essential part of the financial planning of practically every living American, remains relatively unregulated.

Fifty state insurance laws, no two alike, interpreted by fifty state insurance commissioners (some of them temporary or political appointees and many doubling in brass as state banking or securities commissioners), present a picture of confused regulation. The commissioner in South Dakota is also the state fire marshal, runs the state hail fund, and is in charge of the state bonding office.

The insurance department of New York state has consistently tried to maintain a high standard of insurance regulation. Many companies, unwilling to meet the New York standards, simply don't sell there. The rest of the country is open to them.

Donald C. Burns, executive vice-president of the California Association of Life Underwriters, warned recently that unless the drastic differences in legislative and regulatory standards between the states are ended, federal regulation of the industry is inevitable. Said Burns:

> It is not enough for a few states such as California and New York to have high standards of regulation while other states have understaffed, uninformed, apathetic insurance departments dominated by one segment of the industry or another. If state supervision is going to be able to withstand growing congressional and industry scrutiny, a large number of states are going to find self-improvement mandatory.

If national standards of conduct are set for, say, the investment industry, why should not similar national standards be

set for the life insurance industry? The very thought of such a development terrifies that industry.

Although the Supreme Court ruled in 1944 that life insurance was interstate commerce and therefore subject to federal regulation, absolutely nothing has been done by Congress to bring such regulation into being.

Regulation by the states is impractical. In too many instances, the commissioners are not career men. In some cases they have had little experience with insurance. The 31-year-old commissioner of a Midwest state had spent two years with a small casualty company. Prior to that he was engaged in farming. There's nothing wrong with farming but it doesn't particularly qualify a man to be insurance commissioner.

I think that we should establish standards of conduct and practice, and demand that those who regulate—and those who are regulated—be guided by them. I do not for a moment doubt that the circumstances under which a former superintendent of insurance of New York state became a vice-president of the New York Life and the first deputy superintendent of insurance in New York resigned to become a vice-president of Mutual Life of New York were unassailable. I just think that we should make it impossible for a high official charged with the regulation of this vital industry ever to be in a position where his decisions relating to a specific company may influence his appointment to a high-salaried lifetime job with that company.

The actuary of a leading state insurance department is the retired chief actuary of a prominent insurance company domiciled in that state—his present office is only a few city blocks from the one he occupied for years with the company. As actuary, he is the senior career man in the state insurance department, the men senior to him being political appointees. Most of this man's business career was spent figuring out how to make money for the company which employed him. He draws a pension from that company. It's expecting a lot now to ask him to put on another hat and, as the representative of the people of the state, scrutinize critically the reports filed by that same company. Mindful of the inroads of inflation upon its pensioners, the company might, if its profits grew, elect to increase that pension. Can or would a man in such a position criticize a company's practices or reports or do any-

thing to lessen its profits? Perhaps so, but there is room for honest doubt.

I am certain that the individual of whom I write is an honorable man who will try to do his job well. I simply contend that he might naturally tend to view things from the standpoint of the company. To expect more than superficial regulation of insurance companies from public officials who were their employees and are still perhaps on their payrolls, or who are going to become their employees, is asking a lot.

This very question has already been raised in court. The insurance commissioner of Maryland, appearing in court to defend a taxpayer's suit, denied that his pension from the Great American group of companies created a conflict of interest. In the suit, which demanded that he resign, the claim was made that he "has an interest in the financial success of the Great American company for the reason that if the company prospers, there will be more likelihood that the defendant will continue to receive his full pension benefits or that the benefits will increase." The court found for the commissioner.

An astonishing aspect of the regulation of insurance companies by the states is the practice of charging the examined company for the cost of the examination. How can any regulatory agency assert a claim of independence when the party being examined pays the cost of the examination on a per diem basis? If the states expect to preserve their roles as guardians of the public interest in the insurance field, they must be prepared to assume the burdens, including the cost, of discharging their duties.

A congressional subcommittee which recently looked into some of the practices in the insurance business was given a shocking picture of the inadequacies of the examination system. The practice of charging companies a per diem rate plus expenses for examiners resulted in needless make-work projects. It was disclosed that incompetent examiners had abused the practice by prolonging jobs unnecessarily to the great expense of the company and the personal profit of the examiner. Few objections are raised by the companies for fear of retaliation by the examiner through adverse reports. Conversely, examiners who can ride this gravy train without repercussions from the company footing the bill are

unlikely to submit critical reports that might disturb their benefactors. In all likelihood, the great majority of examiners are above this sort of thing. The system is one which encourages abuse, however, and it should not be permitted.

The congressional committee also learned that it was common practice for state insurance commissioners to utilize the examiner positions as patronage to enhance their own political fortunes. Instances were uncovered of nepotism and the appointment of persons with no qualifications for the job.

The inquiry also developed evidence that state insurance departments did not always deal in a forthright manner with complaints. Such complaints are seldom investigated by the departments themselves. Instead, the parties complained of are queried and asked for an explanation and the answers are "analyzed for appropriate department action."

Counsel for the committee reported that the probe, which was far from thorough, found evidence of "management policies which might waste the policyholders' equity." "Irresponsible dividend policies," he said, had brought some companies "to the brink of failure."

Commissioner Sherwood Colburn of Michigan chided the industry for its lack of interest in improving conditions and demanded that it "rid its ranks of the gimmicker, the peddler, the unethical." Said Colburn:

> When, oh when will the sleeping giant again yawn? Will it only be after state regulation has gone down the drain, or am I flattering these same segments of industry by thinking that even federal regulation could make them yawn, let alone wake up to the realities of the twentieth century?

A news story in the April 13, 1962, issue of *The Insurance Field* was headlined MICHIGAN COMMISSIONER COLBURN FEARS FEDERAL CONTROLS. Why should he fear federal controls?

The Illinois insurance department drew up a new set of regulations of insurance practices and invited the industry to comment on them. Timothy W. Swain, general counsel of State Life of Illinois, said that while the intent of the regulation was good, "it would hamstring all life insurance salesmen."

Two powerful trade associations opposed the new regulations with a statement that while they were sympathetic with

the department's efforts in the public interest that false, deceptive, or misleading statements either in advertising or in the presentation of life insurance not be permitted, they nevertheless felt that "in this competitive age it is equally important—what with the increased competition from within the industry and from powerful competitors outside of the industry for a share of the disposable personal income—that the life insurance companies not be unduly limited in the scope of effective advertising and sales promotion by means of too restrictive rules and regulations." The insurance department noted that many companies opposed the new regulations on the ground that they would "adversely affect advertising practices which had been acceptable for years."

And what were these new regulations which so upset the industry? Well, one of them banned the practice of "including in sales kits and prepared sales presentations proposed answers to a prospect's question as to whether life insurance is being sold, which are designed to avoid a clear and unequivocal statement that life insurance is the subject matter of the illustration." They also forbade "stating that a policy provides certain features which are not found in other insurance policies, unless that be true." The proposed regulations prohibit a statement that life insurance is "lossproof" or "depression-proof."

Why should the life insurance industry wriggle and squirm over regulations which seem only to call for simple honesty? Does not its opposition prove how badly it needs regulation?

Mehr and Cammack, in their authoritative *Principles of Insurance,* have stressed that the business of insurance must be subject to a greater degree of regulation than others. A business affected with the public interest cannot be allowed the same freedom of operation as other business, they contend.

Kimball and Jackson, in their recent, excellent *Regulation of Insurance Marketing,* reported:

> One of the characteristics of insurance regulation in the United States is the imposition on state insurance departments of tasks more numerous and difficult than they can perform with the available resources. Choices must be made of those regulatory activities most deserving of allocation of the limited funds. Although there is a great need in some states for much closer attention to the solvency of

the companies, which is the prime object of all insurance regulation, the proviso of the McCarran Act puts such pressure on the states to regulate unfair market practices that they must allocate some part of the department resources to this task. In most cases, this allocation is inadequate. The impossibility of effective control with available resources requires re-definition of some of the offenses with a view to the realistic delimitation of the departments' activities.

The congressional committee studying insurance concluded that something should be done to maintain the dignity of the state commissioner's office. Said counsel:

It is demeaning for commissioners to be required to attend semi-annual meetings of the National Association of Insurance Commissioners without providing them with adequate funds for living expenses commensurate with their station. The result is dependence upon the largesse of company officials for dining and entertainment, with consequent danger of undue influence.

This editorial appeared in *The Insurance Field* (August 3, 1962):

Joe Hunt, Insurance Commissioner of Oklahoma, has written the following "open letter" to Rufus D. Hayes, Louisiana Insurance Commissioner and President of the National Association of Insurance Commissioners:

"I would appreciate your not assigning me to any committees of the NAIC. I find it financially impossible to continue to attend meetings on the $14 per diem allowed me.

"Legislators need to increase appropriations and personnel of State Insurance Departments *if we are going to hold the line against federal intervention.*" (Italics added.)

The *Field* concludes that "most insurance departments are helpless to impose proper regulation because of inadequate funds." Don't fail to notice the significant reference to holding the line against federal intervention. However poorly they

may be doing the job themselves, they want at all costs to avoid letting the federal government do it.

Recently, Harry McClain, Indiana insurance commissioner a quarter of a century ago, was reappointed to the office. He found that the personnel of the actuarial division of the department numbered exactly the same as when he left office 24 years earlier.

Bear in mind that none of this has anything to do with the setting of the rates at which life insurance policies are to be sold. As the American Society of Chartered Life Underwriters boasted in its syndicated newspaper column, "No state insurance department has the right to determine the premiums a company charges for its policies."

Free Enterprise Running Wild

Operating with no legal regulation of its rates, the institution of life insurance has proved that it cannot or will not voluntarily establish fair premium rates based upon modern mortality tables.

I share the feeling of those who hold that government should not intrude upon business. However, when an industry whose product is so vital a part of the economic well-being of all our people shows itself unwilling to regulate itself, and when state regulation has proved ineffectual, the only answer is for the federal government to step in and provide that regulation. Indeed, it is a mystery why such federal regulation has been so long delayed.

Recalling the circumstances of the moratorium, Sherman C. Kattell, recorded in the *Transactions of the Actuarial Society of America,* spoke of the "lack of uniformity" in the confusing action of the 27 different states which by departmental edict gave the moratorium the effect of law and concluded: "A situation such as this one is one of the very good arguments for federal control of life insurance."

The *National Underwriter,* reporting an address by Colorado Commissioner E. V. Omholt to a meeting of that state's insurance men, said:

> The commissioner . . . said that federal intrusion has created many problems for both the industry and his office, and called for action to "stem the advances of government incursions."

In the very next breath, the commissioner pleaded for closer cooperation between the companies and his office to "expose fraudulent representatives." Fraudulent misrepresentation and omission of material facts is the hallmark of modern life insurance sales. Nowhere is there effective state regulation of insurance selling. Even those authorities who recognize and acknowledge their own inadequacies nevertheless spend a good part of their time fighting to "stem the advances of government incursions." The time might better be spent fighting to protect the policyholders.

Is state regulation adequate in terms of the maintenance of financial stability by the companies? Let us take the testimony of the president of the National Association of Insurance Commissioners. Warning that "the inflationary period in which we are now living *has already made inadequate* the capital and surplus requirements of life companies," Louisiana Commissioner Rufus D. Hayes told the American Life Convention in Chicago in October 1962: "The imperfections of state regulation must be recognized by the regulatory officials and by the industry."

Naturally, the companies are bitterly opposed to federal regulation. Buist M. Anderson, vice-president and counsel for Connecticut General, appearing before a New York legislative committee on insurance rates and regulation, said: "We do not want to see life insurance companies placed in a regulatory strait jacket hamstrung as are the railroads. For this reason we do not want national regulation of insurance, whether it be administered from Washington or Albany."

The anticipated trend suggests that another 10 years will find Americans owning more than a *trillion dollars* worth of life insurance. This means that we will probably purchase in the next decade nearly as much insurance as was purchased over the past century.

An institution which is such an important economic factor in our lives—and such a drain upon our pocketbook—must be subjected to continuous scrutiny to eliminate the abuses which have developed since the Armstrong investigation of 1905 and prevent other abuses.

Considering the breathtaking size of the industry and the influence it wields with its enormous concentration of assets, it is hard to believe that it has run wild for so long.

It is common practice for groups with a special interest to lobby for that interest. In one way or another, insurance

touches the life of every American. A large portion of our total personal income flows to the insurance companies. Should we not, a hundred million strong, lobby for the stricter regulation which is obviously needed?

Distributors of investments are strictly regulated under securities laws administered by the Securities and Exchange Commission. Every solicitation must be accompanied by a prospectus giving all material facts about the offering. We make up our minds on the basis of facts presented in writing, not upon glib sales talks designed by home-office sales psychologists. Why should we not require the insurance companies to present a prospectus explaining costs, benefits, rights, and privileges? Is there any reason why the insurance industry should be reluctant to describe its product in writing?

Why should the Prudential Insurance Company, trying to get permission to sell its variable annuity policy, take the stand that it will drop its plans to bring out such a policy if it is required to give a prospectus to buyers?

John D. March, president of Variable Annuity Life, speaking at the American Life Convention on the problems posed by SEC prospectus requirements, was reported in the *National Underwriter* for October 21, 1961, as saying:

> From the marketing standpoint, the fundamental problem will be related to the prospectus which will be required if the Securities and Exchange Commission is successful in exercising jurisdiction over segregated account contracts. For the first time, the agent will be required to deliver a detailed prospectus at or before the time of sale. This prospectus will set forth in intimate detail all of the costs attributable to the contract. *Imagine,* if you *can,* the problems that would be encountered by the agent if he had to deliver such a detailed prospectus with a traditional fixed dollar contract, and if the prospectus spelled out on the front page all of the expense factors attributable to the contract.
>
> However, we do know that the mutual fund industry has been highly successful despite the necessity of delivering a prospectus. Accordingly, there is every reason to believe that our industry will be able to overcome the psychological aversion which we may have to the prospectus. It will have the advantage that the prospect will never be

able to say that the contract was not properly explained to him. From the standpoint of the companies issuing participating contracts, they will be prevented from projecting dividends under the usual SEC rules and all that they will be able to show is past investment performance.

Don't you agree that an industry which has a "psychological aversion" to letting people know the costs of what they are buying is badly in need of regulation?

An industry spokesman, Harold Franklin, president of the Association for Advanced Life Underwriting, has sounded a warning:

> It has become apparent that the speculative fever which has dominated our nation's business for the past decade has crept into the life insurance business. Longstanding traditions have been swept aside by the siren promises of increased production. Carefully husbanded surplus reserves created by years of conservation are financing the free-swinging battle to acquire new policyholders. "How big" has replaced "how sound." New companies, many with little to contribute to society, are "going public" because life insurance stocks are "hot!"
>
> Looked after by state insurance departments, we remain the only financial institution not governed by federal laws. . . .
>
> We have but little time to reverse trends which, unless reversed, will make us the target of a new investigation. For, as an industry, all are tarred with the same brush. Indictment of one will be an indictment of all. No one will escape the demands for greater public control and policing. Our history books are crammed with examples of bureaucracy moving in where self-policing has failed. Our only alternative to government action is self-respect, self-policing and self-enforcement. If an important segment of our industry does not awaken to responsibilities owed the policyholders, we're going to deserve the restrictions which will be imposed by new federal legislation. We won't like it; but, once on the statute books, it will never be repealed.
>
> Recent articles dealing with [replacement] have ignored the policyholder's interest, to deal instead with the loss to the company due to the lapse. We have suggestions that if lapses and replacements continue to mount, dividend

projections based on previous experience, prior to the high lapse rate, will suffer. We have other suggestions that present commission schedules with high "front money" will have to be adjusted, so that the agent bears his share of the policy's failure to stay on the books. We know, of course, that adjustments in commissions will not stand the test of competition for new business unless all companies make a similar adjustment at the same time.

An individual or an industry which considers itself above reproach and underestimates the force of public opinion is riding for a fall.

We need no further headlines. We need no further legislation, but we do need some honest re-evaluation and self-policing of the abuses against the policyholder.

Some companies are developing mutual-fund affiliates, and their agents are selling a package plan. The insurance is always cash value insurance, though. In the *National Underwriter* for January 29, 1961, Levering Cartwright, a Chicago stockbroker whose firm specializes in life insurance company stocks, wrote about one such combination:

This group was looking for some answer besides simply the use of term insurance as an envelope for a contractual mutual fund deal. Standard Life, for instance, issues only ordinary life or better in conjunction with a mutual fund scheme.

A disquieting possibility is that the large number of untried newcomers to insurance may plunge into the sensitive securities field without being well-cautioned or properly conditioned. They might then create situations which would invite or provoke closer federal regulation not only of the securities phase of such operation but life insurance as well. Federal regulation has long been a spook. Here could be a substantial reason for the spook to don whiskers.

Note that in connection with the package deal, the company issues only "ordinary life or better." Better for whom? The tongue-in-cheek reference to Uncle Sam as a spook will produce only hollow laughter from many who hold that federal regulation is long, long overdue.

At a seminar for 80 insurance executives from all over the country (according to the *National Underwriter,* September

29, 1962) Ronald G. Stagg, vice-president of Lincoln National Life, discussed the suddenly popular practice of having casualty insurance companies set up life company affiliates. One of the reasons for these combinations, Mr. Stagg observed, was to enable the casualty company to "take advantage of the relatively few statutory and regulatory rate controls found in life insurance."

Why should there be "relatively few" statutory and regulatory rate controls in an industry which has had an income of *$260 billion* in the past two decades? Why should people outside the life insurance industry be licking their chops at the happy prospect of getting into a business where regulation is a farce? What are we thinking of to let such a situation continue to exist?

Not Even a Little Regulation

Insurance men, shocked at the rate at which their renewal commissions are melting away because of wholesale replacement of existing policies with new minimum deposit contracts, are moaning that there should be regulation to stop the cannibalizing of their business by their fellow agents. The president of the National Association of Life Underwriters, R. L. McMillon, has warned them that they'd better lower their voices about regulation or they'll all be up the creek. Said he:

> There is danger in our zeal to correct the replacement problem of which we must beware. Personally, I have always felt that this is the industry's problem and the industry's duty to solve and correct. It is most unfortunate when state regulatory bodies must step in to correct a situation such as this. There is danger in our being too hasty in asking for regulation from the state departments of insurance. The entanglement of good life insurance men in regulation of detail, especially as regards the mechanics of selling, could adversely effect good morale and in time create for us a greater problem than we are trying to cure.
>
> Therefore, let us be careful as to how quickly we soapbox for regulation in our various states, recognizing that this is an area of our lives which we and the companies should clean up for ourselves. It should not have to be done by insurance departments. Granted that some regulation

may be desirable to correct the replacement issue, let us encourage caution and uniformity as it is accomplished.

Most of all, let us who are members of NALU speed up our efforts to wash our own linen of this blight on the industry. We have our share of the washing to do.

Wrote the editor of *The Insurance Field:*

> I don't think that the insurance producers of America want any commission legislation of any description because if commissions are ever "regulated," then goodby American Agency System!

To these insurance men, regulation is like good French perfume—a little of it might be pleasant, but they don't want to be doused with it. You'll notice that they particularly don't want any regulation of the "mechanics of selling," as McMillon puts it. This would adversely affect their "good morale."

This poses a problem for us—shall we just let them go happily along on their carefree, unregulated way, or shall we, at the risk of adversely affecting their morale, lay down the law—the federal insurance law, administered by a federal insurance commission?

Chapter 29

Sales Methods

There's no one with endurance
Like the man who sells insurance.

THIS ANCIENT COUPLET remains as apt now as when it was first heard half a century ago. The legendary persistence of the life insurance man with his mawkish appeal to emotion is known to everyone old enough to sign an application.

The American Institute for Economic Research, in its useful publication, *Life Insurance and Annuities from the Buyer's Point of View*, discusses the problem of dealing with the insurance agent:

> The first requirement for anyone who hopes to have satisfactory relations with many life-insurance agents is to develop a wholesome respect for the agent's ability as a salesman. The man has been carefully selected in the first place as a congenial personality. He has been trained by masters in the art of salesmanship, and everything that might be at all distasteful to a prospective buyer has been eliminated insofar as that has been possible.
>
> In addition to the development of his personality, the agent has been given sufficient knowledge of insurance to make him a potentially dangerous source of information from the buyer's point of view. Probably he knows practically all the good points concerning his own policies and some, at least, of the bad features to be found in the policies of other companies. He has been given a smattering of actuarial knowledge, including a vocabulary that you may not understand. Skilled mathematicians have devised means for comparing his policies advantageously with those of almost any other company; and these methods you can expect the agent to know, even though he may not fully comprehend their implications.
>
> He is obviously convinced that what he is doing is in your interests. His convictions ordinarily are honest in that

they are sincere, but this does not necessarily imply that they are correct.

Finally, he is receiving fairly high pay for selling insurance. His commissions well reward him for persuading you to buy and retain in force a $10,000 policy. Obviously, then, however good his intentions may be, the agent is hardly a disinterested party.

What Price Salesmen?

Blake T. Newton, executive vice-president of the Institute of Life Insurance, speaking at an insurance convention at Bal Harbour, Florida, was quoted in the *National Underwriter,* May 6, 1961, as saying: "Despite an expenditure of two billion dollars per year on the care and feeding of our field operations, the turnover rate in our agency force shows no improvement."

Two billion dollars! In 1960, the latest year for which detailed figures are available, the insurance companies paid 1,718,179 death claims. The beneficiary of each of these claims received the cash value of the policy, to which the company added enough insurance to bring the total up to the face amount of the policy. The amount thus added by the company represented the actual amount of insurance in force. It totaled less than $2 billion—the companies paid less as death claims than they paid for the "care and feeding" of the life insurance sales force. This is a fantastic situation.

Mutual Life of New York called in a group of university placement officers to discuss college-recruiting problems with the company. The *National Underwriter* reported (January 27, 1962):

> The officers reported that on the whole the image of the life insurance salesman is far from favorable. He is considered to be a fast-talking, high-pressure operator. Consequently, there seems to be more aversion to life insurance sales and salesmen than to other types.

Donald E. Shopiro, outspoken president of the New York State Life Underwriters Association, warned his colleagues:

> The image that a large segment of the public holds is not nearly so flattering to our ego. How do we expect the

public to view our business when we see a man spend a few nights studying to pass an agent's qualification examination, and then turn up a week or two later with an announcement that he is a specialist in estate planning, business insurance and pension plans?

Earlier, I spoke of the competitive scramble among the companies for the services of the agents and of the unsound commission practices and other developments which have led up to the present intolerable state of affairs.

Newton lamented these practices:

When, in an effort to deal with some or all of the conditions, some of our companies engage in activities that seem to corroborate rather than destroy the charges of their competition, surely the time is here when analysis and action based upon the results of that analysis is not only indicated but overdue.

Holgar J. Johnson, retiring president of the Institute, in his farewell speech early in 1962, expressed his concern at the trend of developments within the industry:

One aspect which seems to me to need closer study lies in the area of our sales techniques. I sometimes wonder if we have become so product-minded that we have tended to overlook what the basic purpose of life insurance really is. In our attempt to be all things to all people, we have at times tended to emphasize the things which life insurance can do—but not as well or certainly not better than others can do, rather than the things it alone can do.

Later, at a seminar of insurance men in New York (reported in *The National Underwriter*, June 9, 1962), Johnson warned again:

If there are any life insurance people who disregard their responsibility to their policyholders by making exaggerated statements of the contract or over-estimates of their dividends, or try to imply that life insurance does anything other than what it is supposed to do—we had better be careful.

Lester O. Schriver, retiring executive vice-president of the National Association of Life Underwriters, warned the General Agents and Managers Conference that the life insurance business faces "more numerous and more serious problems in the next decade than in any comparable period—including the first decade of this century."

The first decade of this century saw the Armstrong investigation which turned the life insurance industry inside out and ousted hundreds of its leading figures. Will the industry heed Schriver's prophetic voice and clean house? I doubt it.

Only a few months earlier, Schriver had been quoted in the *National Underwriter* (September 20, 1961) as saying:

> Generally speaking, the [life insurance] field has been inclined to oppose change instead of trying to understand the public interest and the public mind.
>
> I think we will ultimately be forced into the position where we must ask ourselves, "Shall we sell the public what it wants or what we think it ought to have?" What the public wants, the public generally gets.

Holgar Johnson, for 22 years the professional head of the trade association of life insurance companies, resigned with a warning to the industry that it was becoming too product-minded, that it was trying to be all things to all people and to extend the use of life insurance into fields more properly left to others.

Lester Schriver, for years the professional head of the trade association of life insurance salesmen, resigned at the same time, with a solemn warning that another Armstrong investigation or worse lies ahead. These two conscientious men want no part of it.

Stuart A. Monroe, newly elected president of the Chicago Life Underwriters Association, told the association's annual meeting in June 1962 that the new regulations proposed by the Illinois insurance department were necessary because "some companies have attempted to roll in volume through the use of coupons, loose talk about profit sharing and investment yield, references to the history of older companies, as well as presenting dividend scales of other companies with no validity when applied to the selling company. The use of gimmicks, deceptive sales expressions and less than honest

sales methods cannot be countenanced because they confuse the buyer and the public will lose confidence in us and our industry."

Complained David B. Fluegelman, a prominent New York CLU: "There has been reason to suspect that some companies are no longer creating an image of which they are proud, but are accepting business on the basis of expediency, regardless of its effects upon the agency force or the buying public."

Fred C. Wright, Jr., assistant professor of the College of Commerce of West Virginia University, told the Southern Agents' Conference at White Sulphur Springs: "The public is receiving very bad treatment from insurance agents."

Raymond T. Smith, Best's vice-president from whose speech to the Chicago Investment Analysts Society I have already quoted, had this additional observation on that occasion: "Some few companies, unfortunately, produce business by high pressure methods which naturally results in a lapse ratio higher than the industry average."

In 1961, the outgoing president of the National Association of Life Underwriters described some of the present practices as "a breakdown of the moral precepts and ethical standards, concepts which once played such an important role in building the life insurance business."

Harold Franklin, president of the Association for Advanced Life Underwriting, warned in March 1962 of the need for self-policing and self-enforcement in the industry:

> In the February issue [of *The Insurance Field*], questions were raised about the direction toward which our industry is headed. I cautioned against delusions that we are above reproach and called for a re-awakening of the need to exercise our responsibilties.
>
> It may become too late for the answers if we wait until the public raises the questions. Certainly, it will be too late for answers if we find ourselves bogged down in a morass of bureaucracy resulting from a Congressional investigation.
>
> In an almost complete disregard for common sense, we permit practices and accept standards which are conceived out of avarice and greed, with little concern for the policyowner's long-term interest."

The *National Underwriter*, reporting (August 9, 1962) that the Colorado Insurance Department was considering new, stiffer regulations because of the increasing number of complaints of misrepresentation which were being filed, said: "The legitimate business suffers as purchasers of the gimmick policies become disillusioned." The new regulations would prohibit any reference to a life insurance policy as being an investment.

One of the great figures in the history of American life insurance was Elizur Wright, who became the insurance commissioner of Massachusetts 80 years ago and, in that capacity, forced the insurance companies to set aside reserves to preserve advance premiums paid under the level premium system. Wright also required the companies to provide nonforfeiture cash and loan values for the first time. Never before or since has a public official fought so vigorously to protect the insurance policyholder.

Elizur Wright wrote, in his book *Politics and Mysteries of Life Insurance:*

> There was included in life insurance, at the start, too much falsehood, not by evil intention, but by want of thought. . . . Nothing which is good for society courts concealment. . . . Life insurance will be good for society when the policy conceals nothing.

Joseph B. MacLean, in his authoritative *Life Insurance*,[1] spoke of the sales methods in the past and said: "Undoubtedly some of the growth of this period was forced and unhealthy. There was a good deal of high-pressure salesmanship and over-insurance."

John O. Todd, former president of the Million Dollar Round Table, speaking at the organization's annual meeting at Bal Harbour, Florida, was reported in the *National Underwriter* (July 1, 1961) as cautioning his listeners against submitting to clients proposals which "will not pass the 'smell' test."

Executive vice-president Charles H. Schaaf of Massachusetts Mutual told the annual meeting of the Life Insurance Agency Management Association: "Life insurance is not

[1] 9th edition, McGraw-Hill Book Company, 1962. Reprinted by permission.

bought voluntarily. It must be sold, and this applies particularly to cash value life insurance. . . ."

Urging an end to what he called "hanging out our dirty linen in public," Schaaff concluded: "Sometimes I think much of this stems from competitive factors or frustrations over our own problems or failures. But why start a crusade, an investigation, an industry committee, or worst of all, an appeal to the state or federal government to step in?"

R. L. McMillon, president of the National Association of Life Underwriters, speaking at the organization's Chicago convention, said:

> As we search our hearts, we must ask the question, "What motivates our desire to produce at year's end such an overwhelming financial statement as relates to volume of life insurance produced?"
>
> Is it selfishness? Is it pride? Is it jealousy? Are we compromising principles of good judgment? Are we engaged in a practice which our forefathers would have frowned on? Most of all, are we true to the public trust and will our actions of today stand the white light of public scrutiny tomorrow?

John Barker, Jr., vice-president of New England Life, expressed a curious reaction at a panel on "replacements" (a euphemism for the wholesale churning of life insurance policies by agents) at a meeting of the Association of Life Insurance Counsel in New York. Deploring replacement, Barker said: "This is probably the greatest threat to our traditional system of marketing life insurance that we have encountered since the Armstrong investigation was conducted 50 years ago. . . ."

The Armstrong investigation did much to clean up the life insurance business. It threw the rascals out and established standards of honesty and fair practice, but to Barker, it was a "threat" to the "traditional system of marketing life insurance." Noting that his own company had "reduced unsound replacements by our own agents to almost negligible proportions," Barker reminded his listeners of the commissions involved:

There is another very practical consideration which should be of major concern to the life insurance agent. He is currently the beneficiary of an unusually favorable method of compensation. Many of our companies have provided fringe benefits for the full-time agent in the form of group life and health protection and retirement benefits, but beyond these are the renewal commissions and service fees which are deferred for years following the original issue of the policy. Furthermore, the courts have sanctioned an actuarial method for spreading the renewal commission interest over a period of years on a level basis.

Portents

Joseph B. MacLean, retired vice-president and actuary of Mutual Life of New York and a leading elder statesman of the industry, wrote in the *National Underwriter* for February 18, 1961:

> I get the impression that volume is the No. 1 interest and objective in many companies and that the interests of the policyholder, while admitted to be important, are secondary. This is a situation which may rise to plague the companies when the next full dress investigation of life insurance rolls around, as it surely will.
>
> One result of the emphasis on volume is that the agents have for some time been "feeling their oats," and are more and more asserting a right to a say in management and the right to tell the companies what they can and can't do. I think that this is bad. Management belongs in the home office and should not be subjected to agency pressure. The job of the agent is to sell the company's product.

This distinguished author of the book *Life Insurance* had earlier written a letter to the *National Underwriter* deploring the vanity of insurance salesmen who band together in local, state, and national associations of life underwriters. Observing rather gruffly that they were just agents and should be so identified, MacLean explained: "The duty of the agent is to sell and service as much life insurance as he can. He has nothing to do with underwriting."

A chartered life underwriter, Ellen M. Putnam, writing in

The Insurance Field (August 18, 1961), deplored minimum deposit and bank loan schemes as simply a tax gimmick, saying:

> In the past five or six years, the insurance industry has been appealing to the worst in people: greed, selfishness and irresponsibility in being unwilling to bear a fair share of government expenses.
>
> And unless we change our tactics and do so very soon, we shall lose the confidence of the public which has been built up over the past one hundred years. And do not think that it cannot be lost. It is later than we think.

It is, indeed, Ellen Putnam.

Unbiased Advice?

Here is an interesting story from the *National Underwriter* for September 30, 1961:

> American Illinois Life has been getting quite a play. This is the company which is being developed by a coterie of Million Dollar producers with Hal Nutt of Purdue as consultant. Those placing business with this company are entitled to buy stock at 25¢ per share in proportion to their business. At December 31st, capital consisted of 1 million shares of 25¢ value. On Friday, the stock was 7¼ bid, which placed a total share valuation of the company at $7,250,000. At December 31, assets were $368,239.

Should not such an activity be the subject of careful investigation by the insurance and securities authorities? People are being solicited to purchase life insurance by a group of particularly skillful and experienced insurance salesmen—million-dollar producers.

People buy insurance from agents, not from companies. They trust the agent to place their coverage in a company which his experience and judgment tells him is best for that client. The clients of these high-powered salesmen are not always directed to a particular company on the basis of performance, strength, or standing. The selection of the company may be made because the salesman will thereby be able to buy stock in the company at 25¢ per share. The total cap-

ital of the company may be only $368,239, but already these promoters have run the stock up to a current market valuation of over $7 million!

Does this industry need regulation or does it not?

Robert I. Mehr, professor of insurance at the University of Illinois, and Robert W. Osler, editor of a life insurance publication, co-authors of *Modern Life Insurance*, state:

> The emphasis placed by agents on cash values has become another instance of the tail wagging the dog.
>
> It should also be mentioned that some life insurance agents discourage the purchase of term even in cases where it should be sold, since term insurance yields them a lower commission.

Sales Talk

The emphasis upon cash value and "savings" is universal in the industry. An address by David M. Boardman, an agent for National Life of Vermont, has been widely reprinted in various insurance publications. In it, Boardman gives what purports to be his sales approach. Here are some excerpts:

> If I could show you the greatest savings plan known to man—you to be the sole judge—would you be interested in seeing it? . . .
>
> Now, let's see how this savings plan works. Here is a brief comparison showing the advantages of the life insurance plan over a savings bank plan. Isn't that tremendous? All the problems of other savings mediums are eliminated. Here's how the whole plan works out. . . .
>
> Now, how much do you feel you could save on such a plan?
>
> After determining this, we remind the prospect that it is a long-term savings plan, and cannot be used for the first two years. After that time, if a real emergency or a tremendous need should arise, the money is there for the real purpose for which he started to save. The money he puts in the first couple of years practically pays for all the cost of the life insurance for the whole duration of his lifetime.

First, "advantages over a savings bank plan," "problems of other savings mediums eliminated." Then, the prospect can't

use it for two years but "after that time . . . the money is there." No mention of the fact that the cash value is a fraction of what has been deposited. Just "the money is there." And "the money he puts in the first couple of years practically pays for all the cost of the life insurance for the whole duration of his lifetime."

L. Douglas Meridith, executive vice-president of Boardman's company, National Life of Vermont, has published at the policyholders' expense a compendium of misinformation called *Life Insurance versus the Ups and Downs of Mutual Funds*. I have already challenged him on the inaccuracies and untruths in that book. I now call upon Meridith, as a former insurance commissioner of Vermont, to disavow Boardman's brand of insurance salesmanship or to offer factual proof that the first two years' premiums on a policy in the National Life are sufficient to "pay for all the cost of the life insurance for the whole duration of his lifetime."

Does this industry need regulating or does it not?

Standard Life of Indiana rushed into print with a poster offering a $500 cash reward for the arrest and conviction of "Tom Twister," a rascal whom it identified as being engaged in the business of selling new policies by persuading people to give up old policies. The poster was illustrated with what the *National Underwriter* called a villain-type picture. This was sent to all company policyholders to keep them from eloping with the competition.

At first blush, one might think that this was a real effort at conservation by the Standard Life. In 1960, the company wrote 2763 new policies. It lapsed or surrendered 1961 old policies. It was obviously leaking policyholders. But Fred C. Crowell editorialized in *The Insurance Field:*

> When Standard Life of Indiana's unpredictable [President] Harry Wade made his dramatic announcement early last month that Standard was posting a $500 cash reward for the apprehension of any "twister," we sure meant to smoke a pipeful of candid comment. The fact that we are just getting around to it and to our knowledge Harry hasn't paid off to any Twentieth Century bounty hunters as yet leads us to believe that it was a whopping good publicity stunt which is most likely to end just there.

To the above, Brother Wade replied, in a letter to the edi-

tor: "Just how serious are we about twisting? Is twisting something to be deplored if another company takes business away from us but if we take another company's business are we in that case doing the policyholders 'a great service'?

"I wonder, I wonder!"

Robert W. Osler, president of the Underwriters National Assurance Company, defended replacement on the grounds that the needs of people change and their insurance should change, too. Said he:

> When your honeymoon cottage becomes too small for the growing, post-honeymoon family, you either add a wing or—if you can't because of lack of land—you replace the house, don't you? If a new policy will give you features an old policy doesn't offer, is it morally wrong, unethical or even illogical to replace it? Sure, when you replace a policy, you pay the commission all over again and go through a new contestable period. When you replace a house, you pay the commission again and go through a "contestable period" to find the bugs in it; but if that's the price you have to pay to get what you want and need, you pay it.

Osler's analogy appears to make a lot of sense. The flaw lies in the nature of the replacement. If you sell your honeymoon cottage only to replace it with another small house, you are no better off. Most of the switches are simply from one cash value policy to another cash value policy on the basis of a lower premium rate or a gimmick like minimum deposit insurance. It would be all right if people were discovering the futility of "permanent" insurance and switching to term. Actually, they have no greater understanding of this new purchase than they had of the original one. Once more they are buying blindly, with faith in an agent. And once more they are being led up the garden path.

This is the real tragedy of replacement.

The American Society of Chartered Life Underwriters, headquartered in Philadelphia, supplies a twice-weekly column called *Your Life Insurance* to newspapers all over the country. This column misinforms people on the proper use of insurance. A typical example: a policyholder wrote in asking whether he should surrender a $5200 retirement income policy which was now all cash value, with no insurance protection, or continue paying the $289 premium for the re-

maining six years the policy had to run. The column editor observed that by continuing his premiums he would end up with a cash value of $7900 and added "we don't know what you could buy with six payments of $289 which would give a guaranteed return of $2700."

There is a clear implication here that six payments of $289 will grow to $2700—an implication which is thoroughly dishonest. As a chartered life underwriter, the editor of the column knew full well that the increase in cash value was due also to the interest on the present $5200 cash value. To suggest that it was the return on premiums to be paid in the future clearly establishes the lack of integrity of the column. If the policyholder in question continued the policy to age 65, the increase in value would represent an annual interest return of 2¾%. If the insurance editor, as he says, doesn't know where the policyholder could get a better return than 2¾%, he must indeed have been leading a sheltered life.

Hidden Salesmen

Another place to keep your eye peeled for slanted advice is in certain bank trust quarters. In most cities of any size there is something called the Life Insurance Trust Council consisting of local insurance salesmen and the trust officers of local banks. They often work together for their common good—the insurance man recommends that the client make his life insurance payable to the bank trust department at his death (in Chapter 23 we discussed the superiority of this arrangement over the settlement agreements offered by the insurance companies) and the trust man sets up the life insurance trust, mentioning while he's at it that the client really hasn't enough life insurance ("It's nothing to me, you understand, but I'd just like to point out . . .").

Understand, this is not the rule, but there are such a disconcerting number of "exceptions" that it is worth mentioning here.

Some of these trust men make speeches and write articles downgrading term insurance and lauding cash value policies. Be on the lookout for one of these "unbiased authorities" the next time you see a puff for cash value insurance in some journal.

On October 21, 1961, in an editorial complaining about efforts of the American Bar Association to limit the opera-

tions of life insurance men in various aspects of estate planning, the *National Underwriter* threatened that insurance men might "report any evidence of poor legal advice to the proper authorities." The agents might: ". . . be on the lookout for cases in which a lawyer himself has shared in an agent's commissions. It is hard to estimate how many such cases there are, but a good way to find out would be for the organized lawyers to succeed in getting the organized life insurance men so mad that they embarked upon a crusade against the lawyers."

This editorial clearly implies two things: That the practice of attorneys' sharing in the commissions of insurance men is widespread, and that the insurance men of America—and, indeed, the editor of this leading insurance journal—see no moral wrong in the evil practice and would take steps to end it only for revenge upon the legal fraternity for attempting to limit the activities of the insurance men.

Where can the layman go for advice? This editorial says that some of the very attorneys to whom we might turn for unbiased counsel are in league with the insurance men. I cannot believe that any but a very small minority of attorneys would stoop to this. Here it is, however, in black and white from the *National Underwriter*.

Incidentally, there's a monthly magazine published in Washington which makes a big point of the fact that it takes no advertising. Starting out very bravely about 10 years ago, it published a great many interesting articles on a wide variety of subjects. Lately, though, it has been running some dreadful stuff on insurance, some of it parroting material in insurance company sales-training courses. Recently I found the answer. It is selling millions of reprints of these articles to insurance companies for distribution by agents to help sell the public the merits of cash value insurance. Whom can you trust these days?

Other Misrepresentations

Another frequent and popular area of misrepresentation is the taxability of life insurance. Insurance men are given to constant references to the "preferred tax status" of life insurance. They will point out that the proceeds of life insurance will pass to the beneficiary "completely exempt from income tax." To an uninitiated layman who does not know that there

is no *income* tax liability by reason of the passage of *any* property at the time of death, it appears that life insurance offers some special worthwhile benefit. Another favorite tax gambit in the insurance man's arsenal is reference to inheritance taxes. He will make sly mention of the fact that the prospect's insurance will not be subject to inheritance taxes. The average layman thinks the salesman's talking about the taxes due Uncle Sam. He isn't. He's talking about (for most people) relatively minor state death taxes. The prospect dies happy, figuring that he has avoided the federal estate tax, the big bite.

Any property you leave at your death is exempt from tax as income. All property, including life insurance, is subject to the federal estate tax.

Another area to watch involves those pretty charts the insurance men draw with their colored crayons, the ones which "plan" your estate through all the years ahead and end up by showing you how much retirement income you can expect if you will just add this new policy. The income figure which they show at retirement often includes your Social Security income. When they show you a $350 monthly retirement income, they don't mention that you'll be getting $124 of it anyway, whether you buy the new policy or not. One of them got real huffy once when I told him that if he was going to include my Social Security as a "benefit" under his plan that he ought also to figure my Social Security tax contributions under premiums.

You will observe that the agent generally recommends that you allow your dividends to accumulate at interest. When you have a couple hundred dollars accumulated in the dividend account, he'll be around to sell you another policy. When you plead that you don't have the money to pay for a new policy, he'll assure you that there's no problem—if you'll sign the form he offers, the company will apply your accumulated dividends to pay the new premium. "It'll be a whole year before this new policy falls due, and you'll be all set then. Meanwhile, you had some additional needed protection for the wife and the kids."

When he gives you all that talk about mutual companies being owned by their policyholders and thus having a lower net cost of insurance, just remember that mutual company premiums are 15% to 25% higher than stock company pre-

miums—and that means his commissions are that much higher. Sure, they refund the overcharge at the end of the year, but first they pay him his commission on the whole thing. It's the commission dollar he's after.

Robert V. Van Fossan, a superintendent of agencies for Northwestern National, told a life insurance sales congress in Helena, Montana, as reported in the *National Underwriter* for July 1, 1961:

> Since the mid-40's the average life insurance premium has dropped from $30 per $1000 to less than $20 per $1000, and as a result one-third of our dollar market has been lost. As we have shifted from selling 20-pay life and retirement income to "need" selling, programming and estate planning, we have ended up by merchandising a completely unglamorous, stripped-down, functional piece of life insurance.

That's bad? The man grumbles because people demand functional life insurance.

Ghouls and Snobs

The National Association of Life Underwriters, in opposing the reopening of National Service Life Insurance (GI insurance) used the argument that the government would lose taxes on the commissions insurance agents lost because GIs had National Service Life instead of being forced to buy commercial coverage.

Some of them are ghouls. An article by R. B. Mechlenberg in the September 28, 1961, issue of the *National Underwriter* said:

> Considerable evidence was brought out at the meeting of the committee on affairs of veterans and servicemen that in spite of the Defense Department letter of last July requesting companies to discontinue mail solicitation of parents of servicemen, companies are still continuing the practice. He told of the parents of one serviceman who had received 20 letters from insurance companies within a single month. In some cases, they sent along an actual

policy with the parent named as beneficiary and the son as insured.[2]

One company, College Life, uses snob appeal, advertising that its contracts are sold "to college men by college men." I presume that there are an initiation fee, dues, and a secret grip. Don't laugh, they're making it pay. In 1960, their net gain after dividends was $629,545 on only $265,000 of paid-up capital! Their operating expenses were $2,321,419, against $189,497 in death claims. Premium income was $5,903,709, so nearly half of the income went to operating expenses.

Wonder why someone hasn't started a Rotary Life Insurance Company or a Boy Scout Life Insurance Company? Think of the market!

Speaking of selling insurance to young college men, a common practice has been to sell draft-age youths policies with disability and accidental death benefits. In the fine print, all claims for disability and accidental death incurred while in military service are excluded. During the last war, thousands of servicemen paid premiums for three or four war years for disability and accidental death benefits which they could not possibly collect. Would you not have expected the companies to issue a joint statement explaining the situation and offering to waive disability and accidental death premiums during the period of military service?

The motto of the insurance men is "Get 'em while they're young!" College boys are given the high-pressure story of how important it is that they buy life insurance while they're young and it is cheap. They are not told that the cost of life insurance each year is determined by the policyholder's age

[2] In 1961, the FBI arrested 27 persons—including a number of life insurance men—for perpetrating a scheme whereby insurance men sent in insurance allotment blanks for nonexistent servicemen. Army employees in on the plot sent premiums from government funds to the insurance companies. The companies, having no idea that a fraud was being perpetrated, routinely forwarded first-year commissions to the agents. The agents received more than $600,000 in fraudently obtained commissions in this manner.

The ingenuity of insurance men is limitless. The president of a New York agency was indicted on 135 counts of forgery. He took policies in for "programming," forged loan requests and checks; and defrauded 20 life insurance companies, 21 policyholders and three banks of $225,135.

that year and not by his age the year he took the policy out. The boys fall for this and load up with life insurance when they have no dependents to protect, encouraged to do so by the company's offer to take a note that will run "until you're able to pay." The policy delivered, the agent hustles down to the bank and discounts the note. The bank calls for payment in three or six months and when the young man can't pay it, sues him. Many a parent, already hard pressed to pay tuition, has had to bail out a son who fell victim to the high-pressure tactics of the man who sells insurance.

Sales Contests

Company sales contests are marked by special sales pressure and gross overselling, and are inevitably followed by a higher lapse ratio later on when the next premium falls due.

Special sales contests honoring the company president are the signal for increased sales pressure all the way down the line to the field agents who respond to the call by going out and high-pressuring prospects into buying another policy. Countless field men are led into exaggerated sales pitches by the necessity for selling that one last application to complete their quota and send them to the XYZ Mutual's convention at Mackinac Island as a member of the "President's Club" of top producers.

They're pretty cold-blooded characters. Here's an example. The Chicago Association of Life Underwriters complained that Equitable had issued a special group coverage to the National Association for Retarded Children. These fine upstanding defenders of widows and orphans in Chicago issued a statement saying:

> Though we are in entire and sincere sympathy with this group and their misfortune, we consider it improper to permit the emotional appeal of a situation as an excuse for setting an improper future precedent.

Speaking of "the pushing forward of underwriting leniency to a group of this kind," they complained that there would be no end to such special groups. Equitable replied, pointing out that it had paid a commission on the coverage to a licensed agent—as if that were a determining factor in considering whether these unfortunate kids should have insurance.

The *National Underwriter* reported early in 1962 that Missouri Superintendent of Insurance Jack L. Clay was planning action against a full 10% of the life insurance companies doing business in that state on the grounds that they had permitted their agents to use high-pressure methods. Said the *National Underwriter*:

> The new superintendent acted because of a large number of complaints reaching his office about selling methods of life insurance agents. The initial phases of the inquiry have brought to light high-pressure selling tactics that appear to embrace misrepresenting or at least distortion of the facts about the policies being offered for sale by some companies. . . .
>
> Mr. Clay stressed that the situation is not peculiar to Missouri but is going on all over the country, has for some time, and has been increasing in recent months.

It is a pretty strong indictment of the life insurance industry when a state insurance superintendent finds that a full 10% of the companies in the industry are grossly misrepresenting the policies they are selling. Mind you, no one is talking here about the policies which are put out by the "nice" companies who base their rates on long-obsolete mortality tables and who sell 15-year educational endowments to grossly underinsured fathers by using a fanciful dividend projection to make the sale. By insurance standards, this is respectable business.

When an industry grows to the size of the life insurance industry, there are bound to be abuses. There must therefore be effective regulation.

Helpful Ignorance

Here's a quote from the *National Underwriter* which gives you some idea of the sales approach:

> "The successful agent selling pension and profit-sharing plans sticks to the broad outlines of his product and doesn't get himself enamored with the minute particularities," said Charles P. Moore and Richard T. Griffin in a seminar for

brokers run by White & Winston, general agency of the United States Life in New York City.

Mr. Moore, who is an actuarial pension consultant at United States Life, told brokers that the less they could get away with telling the employer, the better.

The *National Underwriter* for October 13, 1962, reported that the San Antonio (Texas) life underwriters at their monthly meeting heard a talk on how to achieve sales success from C. Cothrum of Texas Life. The journal noted that Mr. Cothrum, aged 24 and in the business three years, had compiled an enviable sales record by setting himself a minimum sales goal of five applications per week. Said the *National Underwriter:* "After he explains how life insurance works, if the young marrieds say they want to think it over and will see him again, he returns within 10 or 15 minutes. . . . He said that he makes few repeat calls."

This year more than 18 million life insurance policies are being lapsed or surrendered. I suspect that not a few of these policyholders had been rushed into a long-term financial plan by insurance men who dared not give them more than 10 minutes to think it over and who seldom make repeat calls.

The Life Insurance Agency Management Association, one of the most powerful forces in the life insurance industry, publishes a book called *What You Should Know about Permanent Life Insurance,* in which it holds life insurance up as the only perfect investment. The book is replete with distortions—its very title is a distortion, since it describes as "permanent" insurance policies which in fact consist of *reducing* insurance. It attempted to meet the competition of mutual funds by printing a statement that in the depression years of the early 1930s "mutual funds dropped precipitously in value, some to as low as 1% of their previous highs."

A mutual-fund dealer challenged the authors to produce the names of any mutual funds with such a record. When they could not do so, he demanded that they withdraw the book from distribution or face a lawsuit for heavy damages for maliciously injuring his business by the distribution of false and misleading statements. They withdrew the book and agreed to delete the statement from any future editions.

New England Mutual Life, in its *Life Insurance Guide,* under the heading "Ordinary Life or Whole Life Insurance,"

quotes an imaginary prospect as saying: "I want the most protection I can get for my premium dollar, but I also want permanent insurance with steadily growing cash values for current emergencies and for future income purposes."

The company replies: "The ordinary life policy meets such a need. . . . Its premium leveled over a lifetime, ordinary life provides substantial protection, yet has a constantly increasing cash value large enough to assume real importance as a retirement or emergency fund."

Not a word about the fact that the policyholder will have to cancel his life insurance if he uses the cash value for retirement fund or emergency. No mention of the alternative of paying interest and canceling part of the insurance if part of the emergency fund/cash value is used. Nothing about the fact that the cash value simply represents his own extra dollars which he need never have put into insurance in the first place.

The book continues: "A 35-year old policyholder, for instance, pays an annual premium of only $655.50 for a substantial policy of $25,000 death benefit. If the policyholder dies, the company will pay his wife or beneficiary the $25,000 face amount in cash, or . . ."

In the example, this man said to New England Mutual, "I want the most protection I can get for my premium dollar." The company sells term insurance at his age for $5.07 per year per $1000, or $126.75 for $25,000. It quietly avoided mention of the fact, though.

The Reluctant Term Salesman

The members of my firm have had occasion to analyze thousands of life insurance estates and we are constantly shocked by instances of callous disregard for the best interests of the insured and his beneficiaries by salesmen who sell low-salaried men with big families 20-year endowments and retirement policies. The home offices, far from encouraging the field force to sell low-cost protection, deny the field men full credit toward the coveted Million Dollar Round Table if they sell low-cost term insurance. The salesman who sells term insurance contrary to company instructions is penalized in two ways: he is paid a substantially lower rate of commission on the low term premium, and he is denied volume credit.

Some companies have term policies which they use to get in the door. They sell them if the man doesn't have enough money to pay for cash-value insurance. Thereafter, they hound the policyholder to convert to "permanent" insurance. They collect a commission on the term policy and another on the conversion.

Here are some excerpts from articles written by agents and appearing in the *Franklin Field,* house organ of Franklin Life.

Charles J. Moore writes:

> I convert 90% within two years. In the majority of situations where I have sold Home Protector [a term policy], no other type of plan could have been used because of the necessity of keeping the initial premium low. But I jump at the opportunity of making this sale . . . and, of course, the conversion of the Home Protector to a permanent plan of insurance is guaranteed to produce more commissions.

Jack A. McLeod writes:

> Home Protector conversions are like finding gold. In going over my files for the past 12-month period I find that I have been able to convert $122,171 of Commuted Home Protector face amount for a premium total of $3754.85. This was certainly easy money and the extra commissions earned were merely a bonus in addition to the commissions earned from my regular activities. Recently I had a client of mine call me. He said he would like to have me stop in the next time I was in his area as he was thinking of putting some money into a mutual fund and wondered if I had an investment contract that would give him a better return.

McLeod and Franklin Life apparently did have an "investment contract" which offered a better return. McLeod hotfooted it over and

> . . . asked him if he would be satisfied with a guaranteed return of 3% compound interest on his investment tax free for the first five years which would build up to 5% com-

pound interest (tax-free) within ten years. He was in a 30% personal tax bracket and I of course pointed out that he would have to get a return on his money of approximately 7% compound interest in order to net 5% after taxes in any other investment.

He agreed that it was questionable that he could safely invest his money at 7% compound interest and that he felt that my suggestion offered a very select investment for him.

According to the *Spectator Year Book,* Franklin Life sells policies computed upon the basis of the Commissioners Standard Ordinary Table with interest on the reserve at 2½% or 3%. But McLeod waved his magic wand over these policies and produced an "investment contract" with a guaranteed return of 3% compound interest for the first 5 years, building up to 5% compound interest within 10 years.

Under the heading "Don't Let the Client Down," George H. Windram contributed this thought-provoking gem:

> The client needs this insight into the advantage of conversion privilege perhaps as much as we need the commission dollar.
>
> I then highlighted the benefits of [the Home Protector policy] in about one minute. The policy was then set aside as I did not want to get into its mechanics or to let him get too attached to it.

A heading "Don't Let the Client Up" might have been more appropriate.

William C. Woods wrote:

> Take, for example, a middle-aged man, heavy in debt, who couldn't afford the $43,000 of permanent insurance he now owns. He directly was responsible for earning $8000 a year with a working life expectancy of 17 years—that means he would earn $136,000. His premature death would put his family out of business. If he half-loved his family he would need $68,000 of immediate protection, wouldn't he? He had $20,000 of insurance—he half-loved his family—couldn't afford to own but did rent $48,000 of Home Protector.

A few years passed, debts were retired and again the problem of future taxes had to be thought of. Because he was 50, didn't know what his insurability was, the remaining $23,000 convertible privilege was exercised. Not one but two contracts—yes, two commissions! But the important thing was the perfect answer to his problem. Who in the industry, without Home Protector, could have honestly done a comparable job? I had the desire to help that friend! As a result he believed me—he bought—his problem was lifted from his shoulders and rested squarely on Friendly Franklin. Could anyone be a better friend?

The magazine said of Woods, "We can't help the impression that there is a bit of Thoreau in him, and a bit of Walden Pond in his thinking." I'd say that there was a *lot* of something in his thinking! Did you see him snapping at those two commissions? "I had the desire to help that friend!" Brother!

Porter O. Payne wrote frankly:

The Home Protector is, in my opinion, the finest contract the Franklin Life agent has to offer his clients, as a means of giving him the insurance protection he currently needs and the opportunity of converting at a later date to a permanent plan of insurance. Plus, and the most important, is that you as the agent will receive two full commissions.

Chartered life underwriter Harold C. Aubry writes:

Term insurance must not be sold for the sake of term, but for the sake of future conversion. Term insurance is frustrating since you are merely paying for the cost of protection and therefore you want to convert at the earliest possible time.

Isn't that a prize? "Term insurance is frustrating because you're merely paying for the cost of protection." Well, that gives you an idea of the insurance man's viewpoint.

If you think that it doesn't pay dividends, though, you're wrong. Last year, the hundred leading Franklin Life agents

averaged $42,702.59 income. The hundredth man earned $22,914, the two-hundredth earned $15,597, and the three-hundredth, $11,767. Franklin advertises these figures in the trade papers, saying, "That's a lot of alfalfa!" I agree. It must be those conversion commissions.

Recruiting

Despite these impressive figures, the recruiting of salesmen is an industry headache. The American Risk and Insurance Association is an organization of college and university teachers of insurance subjects. In its publication, *Journal of Insurance*, it carried an article describing the results of a study of the agency recruiting practices and attitudes of 21 selected companies. Here's the way the *National Underwriter* reviewed the article:

> Recruiting for a "natural market" was practiced by all but the two largest companies in the survey. This is the practice of recruiting a man, having him sell a volume of insurance to his friends and relatives, and then determining whether or not he has the aptitude and qualifications for becoming a successful agent. Most companies emphasized a man's natural market as an important consideration in his qualifications.
>
> It was admitted that the practice of emphasizing a man's natural market had been misused by various segments of the business.
>
> The article states that when asked the percentage of total recruits who succeed [remain as long as five years], all but two indicated that they were well above the industry average of one out of ten as suggested in previous research.

The *National Underwriter* reported (October 20, 1962) that one large company in the last nine years has recruited 5000 new men, yet ended up the period with a net increase of only 50. Another company of medium size last year hired 140 and showed a net increase of three. No one is benefiting particularly from the sales race, which is costing the policyholders a fortune. How can an industry with such a personnel turnover fulfill its claim of rendering a professional quality of service?

Nineteen out of the 21 companies surveyed recruited agents primarily to sell their friends and relatives. Only then was the question of the applicant's aptitude and qualifications given serious consideration. If he couldn't tap his "natural market," he was considered a failure. Their definition of a success is a man who can hang on in the business for five years. Success is exemplified by dogged persistence. I have observed that a substantial portion of the life insurance field force consists of agents just coming into the business or agents just going out of the business. Neither group is equipped emotionally or academically to do a creditable job of estate planning. They hold themselves out to be estate planners, ignoring the fact that life insurance is but one facet of estate planning. An important facet, it is true, but not all.

It is the general practice of life insurance agents to condemn equity investments in general and mutual funds in particular. These self-styled estate planners usually represent only one or two companies and are usually committed 100% to the philosophy of life insurance as an investment. How can such men consider themselves professional estate planners when they have only a limited fund of knowledge and such a limited financial perspective? How can they prescribe what the client needs when they have such a restricted program to offer? It is as if a doctor were limited in his activities to dispensing aspirin and penicillin. Regardless of the patient's needs, aspirin and penicillin is what he will get.

Combination

Robert A. Rennie, vice-president of Nationwide Insurance, which has launched its own mutual fund and licenses its agents to sell both insurance and investments, has explained the company's view:

> Agents licensed solely to sell life insurance are under a strong pressure of self-interest to induce the client to buy an endowment policy which they are authorized to sell and to discourage a client's potential preference for mutual funds which they do not sell.

James S. Bingay, vice-president of Mutual Life of New York, dissents:

> Let's suppose a well-intentioned and well-trained insurance salesman offers a choice between a life insurance policy, possibly an endowment contract, and an installment purchase mutual fund tied in with group insurance that will complete the plan if he dies. Now let me ask you, is he not asking his prospect to choose between "yesterday's" model and the "new" model? Regardless of how much the salesman warns and protests, doesn't the prospect understand that he is supposed to buy the mutual fund? Isn't our life insurance agent implying that all of his existing insurance is old hat and should be traded in? Finally, isn't it an implied confession that the whole life insurance industry has been wrong for over one hundred years?

Bingay concludes by acknowledging that direct investment offered "a possibility of better results" but points out that there was no guarantee.

There's the whole story in a nutshell. The people in the life insurance industry are not so much concerned about acknowledging that mutual funds may be "right" as they are about the humiliation of having to admit that the life insurance industry has been "wrong." This is human and understandable. But when the facts are spelled out for them, as they have been many times, and they continue to deny them publicly (while admitting them privately) and go on misrepresenting their product at an incalculable cost to the American people, then the time for patience and understanding is past.

An editorial in *The Insurance Field* for October 27, 1961, called for higher standards in the field:

> The industry's training machinery will have to be overhauled, educational standards raised and compensation plans simplified and fortified. The lapse and termination records of most companies are mute evidence of the need for these things if the industry is to forge steadily ahead.

Turnover

According to Burkett W. Huey, managing director of the Life Insurance Agency Management Association, the industry loses 50% of its recruits each year. The industry's answer has been to intensify rather than improve its recruiting methods.

Armand C. Stalnaker, executive general manager of the ordinary department of Prudential, told a New York meeting that "high agent turnover is created by the fact that only exceptional men succeed in life insurance selling. The average salesman cannot make the grade as matters now stand."

At the annual meeting of the Insurance Company Education Directors Society, John S. Bickley, a professor of insurance, complained bitterly:

> There is no particular interest in a young man who is prepared to enter the business with a thorough knowledge of its vocabulary, concepts, theories and problems unless his personality is more pleasing than that of the history major with whom he is competing.

Desirable Ignorance

The American Risk and Insurance Association, an association of professors of insurance, appointed a special committee to reappraise the whole subject of insurance education at the college level. Concluded the committee chairman:

> ARIA is fighting not only to retain a place for insurance in the college curriculum but also to enlarge that place. You have dedicated men in the association. It is only too bad that you do not have among companies and associations an equal dedication to insurance education that gets them back of the insurance curriculum in fact as well as in lip.
>
> In support of that latter contention is the testimony of many a college instructor who will tell you that more than one "college recruiter" has come to his campus and said he doesn't want a man who ever had an insurance course because such a course only confuses him.
>
> In my opinion, the business as a whole doesn't want insurance education (as contrasted with vocational training which it ought to give for itself). If the business doesn't want it, why should the colleges?

The substance of these last two quotations is that the insurance industry is not interested in a man with a professional knowledge of insurance. It is interested only in a man with a

professional knowledge of *how to sell it*. They don't want salesmen to know what insurance *is*. The industry's slogan is *"Just do as we tell you*. Here is what you say to the customer. Repeat it over and over to people all day long—preferably with emotion. Don't answer their questions—evade them. Don't tell them anything about the policy. Just talk generalities. Keep hammering away at the wife and kids theme."

Hubert J. Freudenberger, a consulting psychologist paid by four large companies at the rate of $60 per man to give aptitude tests, told an insurance group:

> There is no sense in looking for a "normal" or "average" individual or in rejecting neurotics or persons with special problems. They should be rejected only when it appears that their problems will interfere with their effectiveness as agents.

The 1962 Saratoga Springs management conference of the New York State Association of Life Underwriters featured a battle of the sales psychologists and psychiatrists. Here's the way the *National Underwriter* reported the address of a consulting psychiatrist named Dr. Gerald F. Perry, one of a team which has given tests to thousands of prospective agents:

> A neurotic trait can be a very useful one if channeled into the business of selling life insurance. For example, an aggressive, hostile, competitive individual may not be the best kind of friend to have or to live with, but if this aggressiveness and competitiveness is channeled into selling life insurance in order to satisfy his needs for superiority, then he may become a very successful agent. On the other hand, if his aggressiveness and hostility is directed against his fellow man, because of a battle that he has been waging against his father and mother, he will be of hardly any use to the business while still preoccupied actually with his own emotional problems.
>
> As Dr. Perry sees it, the successful life insurance man . . . is friendly, outgoing and presentable. He wants to be liked and he wants to meet people, yet his friendships and interest in his client are not deep.

"The reason for this is possibly that one cannot afford to sympathize and identify with every customer who gives a hard luck story or claims to have a closed budget. With the majority of people living beyond their means, one would never make a sale."

The next time one of these successful though neurotic purveyors of protection stops battling his father and mother long enough to drop in to try out some of his "power phrases" on you, there's no use in your giving him a sob story about how broke you are. He's trained to let your tale of woe roll off like water off a duck's back. After all, as Dr. Perry observed, if the insurance man listened to your hard-luck story, he wouldn't sell you any insurance. He mustn't let his friendship for you and interest in you get too deep. He just can't afford to sympathize with you.

So, the race for successful agents continues. National Reserve Life advertises "fully paid conventions for man and wife." Other companies advertise "lifetime renewals." The Occidental ads say: "The renewals last as long as you do." Thus it is that when an agent aged 25 sells a whole life policy to a young man the same age, by the time they both die at age 75, the agent will have received a renewal every year for half a century. What other business is there where a few minutes' emotional binge can pay off in a lifetime annuity? On the basis of a 6% renewal, an agent who put only a hundred $10,000 whole life policies on the books, with a $25,000 total annual premium, would have a life income of $1500 per year—not starting at retirement age 65 like Social Security, but starting next year!

Commissions are rushed to the men. Some companies have an arrangement under which the local agent deposits the premium he has collected with a local bank which computes his commission and pays him immediately, remitting the balance to the company.

"Training" consists not in educating a man on the subject of life insurance. As we have seen by the testimony of insurance educators, companies are not interested in technically educated men, and indeed avoid them. They seek the jovial, smiling back-slapper who will last the five years which marks a success in the business, and who will, if he does drop by the wayside, at least have the decency to defer it until he has

scraped clean his "natural market," his long-suffering friends and relatives.

To prepare this man to do the conscientious, highly technical job of estate planning of which they boast, they stuff his mind with sales techniques which have made life insurance merchandising a synonym for corny high pressure.

Helpful Hints

Let's look at a few samples from a column of advice to salesmen in *The Insurance Field:*

> Accept the fact that you will die. The sales slant here is quite obvious: the prospect buys life insurance when you kill him. But you don't want to back the hearse up to the prospect's door. Well, I don't believe that you should back the hearse up to the prospect's door, either. I think that you should put the prospect *in the hearse!*
>
> A good way to kill the prospect is by telling a human interest story about some deceased person, preferably a mutual friend, whose death created catastrophic family conditions. Here is a direct quotation from a pass-the-hat letter, sent in behalf of a person who died with inadequate insurance:
>
> > "A number of fellows have indicated their willingess to do something in a material way for Joe's family since they will be in need of financial assistance in the days to come. Since you know that he would like to have given his daughter all the educational advantages possible, we feel that you would like to be one of the many to participate in this gesture to the family."
>
> I don't know what corner of Heaven Joe is hiding in but his embarrassment must be severe. I don't know how you feel, but personally, I would never take a chance on a letter like that going out on my behalf, just so that during my life I could avoid saving a little money in a life insurance policy.
>
> "Kill the prospect, and he will buy life insurance."

This is the work of one Hal Nutt, who is billed as director of the Life Insurance Marketing Institute, Purdue University. Here's another sample of Nutt marketing art:

When you see Mr. Prospect, put your soul into that presentation. Pour forth with that motivation! Open up and really let him have it! If he has a need and has the cash—and if the ticker beats well within his breast—then close him even if you have to insult him. I mean insult. Any man who claims that he loves his family and yet will not provide for them is a stinker. Tactfully tell him so, at first with the help of a motivating story or by means of a visual aid.

If motivating stories and visual aids fail, an insult is in order. If you have your soul in your work, if you have the conviction of purpose which displays real sincerity, an insult will produce results. Then, if you insult him and there is still no sale, don't go away empty-handed. Remember, he has a real need and he has the money. Record his birthday, his wife's, his children's, get information concerning friends, employers, employees, his nephews, nieces, aunts. Then keep sending him visuals, clippings, additional attempts to close by mail. At that point you can forget about him until his age change comes. If again you should prove unsuccessful, keep sending those birthday cards and those age change cards remembering that the toughest character too often is softened up for another agent from another company to easily push over. Remember, this is in reference to a real prospect. You shouldn't waste valuable time on dead beats.

J. R. Martin, second vice-president of Massachusetts Mutual, told the San Antonio Life Underwriters Association that there are agents who will have "none of the sob-stuff and no emotional trickery. Some insist on selling only upon the basis of logic and reasoning." Presumably, these agents are a bare minority, particularly if they are that Nutt's pupils.

Another article in *The Insurance Field*, reporting an address by Wilma L. Jenkins to something called the Women Leaders Round Table Sellarama, was titled, "Appeal to His Greed, Not to His Family Feeling." It starts out: "I never talk about life insurance but rather how to save money. That gets 'em—and how!"

Good old Sheppard Homans, compiler of the American Experience Table of Mortality, who wrote: "There is but one function for the institution of life insurance and that is protection," must be turning in his grave.

The *National Underwriter* reports that Victor Traibush, an agent in Denver for New England Life, found that:

> The disturbing approach and power phrases ordinarily used with good effect in making life insurance sales are worse than useless when it comes to selling the typical research scientist, artist, social scientist, mathematician, engineer or college professor. The intellectual reacts poorly to the everyday techniques of insurance selling. He resents the "disturbing approach" which Mr. Traibush notes insurance men are trained to employ.

It would appear that modern insurance-selling techniques work best with a man who is not given to thinking too hard for himself. The insurance salesman who seeks to sell you by shaming you into it ("a man in your position in the community," etc.) finds intellectuals barren ground.

Like to test yourself with another of Hal Nutt's columns? How do you react to this:

> It isn't even necessary to give a forthright answer to such dumb statements as "I can't afford it," "I want to talk it over with somebody," or "See me later on." He isn't objecting to life insurance, he's just doing what comes naturally. Rather than give a straightforward answer, and get into an argument over a point in which the prospect has all the advantage, why not say:
>
> "I understand your point of view, Mr. Prospect. I appreciate why you would say that, but let me put it this way—"
>
> Then tell him a story, offer an analogy or an illustration. Your story might be a mile away from his objection, or negative statement, but remember that he isn't speaking English and you don't have to answer his objections anyway.

Well, how do you react? Are you ready to sign up? No? What *are* you, some kind of intellectual or something?

This Nutt was so proud of the above effusion that he ran the same column again barely six months later. It must have really brought down the house.

Another insurance publication, the *Courant*, ran an article,

labelled "by the editorial staff, North American Life Assurance Co." all about selling to young men. This will give you some idea:

> Not too many years ago the life underwriter considered the young man a poor prospect. He was thought of as being too immature to recognize the few responsibilities he did have and unable to pay even a modest life insurance premium.
>
> At any rate, the normal sales technique of "backing up the hearse" was seldom successful. Any business which did materialize was small and usually showed a high lapse ratio.

Odd use of the word normal, don't you think?

The Temporary National Economic Committee of Congress, studying the sales methods of the life insurance industry, noted:

> In order to accomplish the ideal of more and more sales, the agent is given detailed instructions on how to break down sales resistance. All the legerdemain of sales psychology is placed at his disposal. "Canned" sales talks and other set speeches to meet objections and to force the final signing of the application are made the agent's stock in trade. He is even told how to modulate his voice and when to smile. Little and frequently no emphasis, on the other hand, is given to standards which will enable the salesman to suit a particular insurance program to the needs and income of his prospect.

The TNEC observed that a number of insurance companies were using for agent training a publication titled *Calling the Life Underwriter*, written by Walter Cluff. In its official report, the committee quoted the following from the book:

> It is seldom necessary to make a full and complete explanation of the policy. In fact, the contrary is true; present merely the high light, as it were, in a few sweeping but carefully selected remarks. Too much detail as we have given in the explanation of the policy, if given all at once, is too confusing.

The thing to bear in mind is that definite details of a policy contract do not sell insurance; that few prospects are interested in the technicalities of the contract. A wise rule perhaps to follow is this; explain just as little as possible.

Mutual Benefit Life instructed its agents: "Make your sales talk simple. Omit technicalities about the mechanics of insurance. Your prospect wants to know what a Mutual Benefit policy will do for him and his family."

Does this not prove that the life insurance industry has a deliberate policy of nondisclosure? Under the spell of "a few sweeping but carefully selected remarks" the American people have been buying a pig in a poke. Not one person in a hundred can accurately describe the policies he owns and on which he is paying a substantial portion of his earnings as premiums. The life insurance men could borrow the phrase of a famous president and say, "We planned it that way!"

The sales literature which the congressional committee asked the industry to submit for inspection exhibited many examples of the high-pressure emotional appeals characteristic of the insurance business. The Travelers advised its agents: "It is better to scare a man into the purchase of insurance than to leave him uninsured."

Not infrequently, people who rush into things without proper thought also rush out of them. But insurance men try to high-pressure a prospect into a decision without giving the proposition careful thought. Our friend Hal Nutt recently presented a column titled *Overcoming Obstacles.* Here is Nutt's suggested reply to the prospect who says "I want to think it over": "Good, Bill. I think you should, since your decision concerns your future and your family's. I'll step into the next room while you think it over so I'll be handy to answer any questions that might come up."

It is precisely this kind of high-pressure salesmanship which has helped to build today's almost incredible lapse ratio.

The Bankers Life suggested its agents make this vigorous statement to a recalcitrant prospect:

> Mr. Prospect, here is the application blank to the Bankers Life I had planned for you to sign today. Put it in your desk, and when you are ready to sign it, let me know. But I don't think I would keep it in my desk, if I were you.

If something should happen to you, your wife will come down and look over your desk. Who is coming with her? Your children? Your father-in-law? Your brother-in-law? Do you want them to find this unsigned application in your desk? Don't give it back to me, because I can't afford to walk the streets with your wife's bread and butter and your children's education in my pocket. Either tear it up or sign it. It's your blank now, not mine.

Now there's a real example of the "disturbing approach" that the insurance men talk about. The prospect of having his mother-in-law dig him up to tell him what she thought of him for not signing the application the family found while picnicking in his office would unnerve the most stubborn character and send him pell mell after the agent, screaming "I'll sign! I'll sign!"

Perhaps you think that when you decide to buy life insurance, you survey the available types of policies, decide which one is best for you, and then buy it.

That's what you *think*.

At a 1962 meeting of the national council of the National Association of Life Underwriters, Executive Vice-president James A. Byrd said:

> Those who say "we're giving the public only what it demands" or "if we don't give the public what it demands, someone else will" to try to explain away deviations from the proved, successful agency system of life insurance marketing are not yet convincing.
>
> The public will buy what life underwriters logically convince them that they should buy and what company advertising may pre-condition them to consider buying.

You see, you're not buying what *you* want; you are buying what the agent wants you to buy, what you've been preconditioned to buy.

I presume that the "deviations" to which Byrd refers are sales of term insurance. I understand that the insurance men are starting something called TIA (Term Insurance Anonymous) which works on the same principle as Alcoholics Anonymous. If because of his conscience or some other sinister influence, an agent finds that he has made several term-

insurance sales and feels that he is falling into evil ways, he keeps the telephone number of the local life underwriters association pasted in his hat, and when he talks with a prospect with 10 kids and finds himself tempted to sell him some term insurance to age 65 which will give him maximum protection at minimum outlay, he excuses himself, hurries to a phone booth, dials the TIA number and three of the brothers rush over and sit with him, quietly reviewing the merits of cash value insurance ("You can lick this thing, Ed!"), until the temptation has passed and, once more in control of himself, he goes back and sells the poor guy a 20-year endowment policy.

A federal takeover of insurance-company assets in the event of atomic attack, with the government using its discretion to decide how claims are paid, has been incorporated into the Office of Emergency Planning's *National Plan for Civil Defense and Defense Mobilization.* Under this plan, the government would seize insurance-company assets in the event of a major atomic bombing attack and disperse them as it saw fit to insureds, corporations, and even to the next-of-kin of victims who didn't own life insurance at the time of death.

Insurance men regard this as a "needlessly arbitrary invasion of private industry." One of them, Charles J. Buesing, manager in New York City for Mutual Life of New York, rushed into print with protestations. Here is Buesing's view, as quoted in the *National Underwriter* for November 11, 1961: "It just gives the self-centered jerk another excuse for brushing off the life insurance agent."

The life insurance man who gives you an emotional hosing-down isn't required to know too much about insurance. One company has developed an electronic-brain computer into which the agent feeds the facts about his prospect. In two minutes, the machine delivers eight possible insurance programs. So here's the script: A character slithers in, all sweetness and light, gets the dope about where you were born and when, gives you the disturbing approach, brushes aside your silly objection with a little anecdote that has nothing to do with the point, pats you on the head, and tells you he'll be back soon with a wonderful message about the best, the most profitable, the safest investment in the world. Hustling back to his web, he squeals on you to this robot which cranks up and grinds out eight possible insurance plans. Before you can

sign the mail and hurriedly leave town, he's back with an armload of "Jumping Juvenile" policies, "President's Protective Investment Plans," and a minimum-deposit plan under which the company pays you to take out the insurance. He may even bring the robot with him!

Where, my friends, are we to hide from this army of tin zombies now being assembled in some insurance Willow Run? The atomic bomb is of minor importance. What we need is a vast, nationwide system of shelters to protect us from insurance men.

Chapter 30

Replacement

For the past three years, the subject of "replacement" has engrossed the insurance industry. Endless speeches have been made at endless sales conferences and conventions, and the trade papers consistently devote their lead stories to the problem.

Replacement, as we have seen, simply means the practice of encouraging people to give up the insurance they already own in order to buy another policy represented as being an improvement over the old policy. Years ago, the practice was called "twisting" and only rascals were said to engage in it. Now, however, such a large proportion of the field force has become rascals by this definition that it has been given the less opprobrious designation of "replacement."

In the days when it was called twisting, there was general agreement among insurance men that there were just never any circumstances in which existing insurance could be replaced with benefit to the policyholder, with just one exception—there was always open season on term insurance.

All that is changed now. It's open season on any insurance policy, not because it is the wrong kind of insurance policy—although it probably *is*—but because "I can get it for you cheaper." Literally millions of people are being told by insurance agents that their present policies can be improved upon. Millions are giving up old cash value insurance only to buy *new* cash value insurance. And there's the rub. If they were replacing their old policies with new policies involving pure protection, it would be a wonderful improvement. They would be regaining title to the cash value or savings tied up in the old policies and reducing substantially their insurance costs for maintaining the same total protection. Alternatively, they could obtain substantially greater protection for the same outlay as before. But they are not buying pure protection. They are buying cash value insurance, similar in one way or another to the policies they are giving up.

The replacements are not being made to improve the status

of the policyholder; they are being made to produce commissions for the agents. One case which came to my attention recently involved a $100,000 policy rewritten in four different companies in nine years. In this instance the rascality of the agent was exceeded only by the gullibility of the policyholder.

The best understanding of the subject of replacement may be gained from listening in on what the people in the insurance industry say to each other about it when they gather in meetings not attended by the general public.

The Life Insurance Association of America gathered at the Waldorf Hotel in New York during the closing days of 1961. As the *National Underwriter* explained it: "To encourage freedom of discussion, it was stipulated that no participant would be identified." Doesn't that strike you as rather peculiar?

It has become commonplace for insurance company presidents to make speeches sanctimoniously decrying replacement. Meanwhile, back at the ranch, the field forces of these same companies are out beating the bushes for policies to replace. I have observed that in many instances the very companies whose presidents have inveighed the loudest against replacement are the busiest practitioners of it.

Within the industry, one of the few critics of the "living insurance" concept is Michael H. Levy, president of Standard Security Life, who pulled no punches when he told the insurance men that the industry has let the old policyholder take care of himself, while "promising the moon" to new policyholders.

Pointing to the shocking lapse rate, Levy said:

> Who is responsible for this unholy mess in which we now find ourselves? Is it a few hundred or so evil-minded agents who run around undoing the good that a hundred thousand honest agents and a thousand upstanding companies have been rendering for years? Of course it isn't!
>
> It's the home office executive who has engaged in the production race. It is the general agent or branch manager who lays production whips on the shoulders of his agents. It is the supervisor who tips off a newly recruited agent to the "smart way" of making sales. It is the agent who sells the client a policy which doesn't meet the client's needs.

A huge percentage of loan-financed insurance has been sold to people for whom it provided absolutely no tax benefit. It was easy to sell, people thought they were getting something for nothing. But the huge lapse rate of such policies is outstanding proof of bad service to the public.

Every one of us must face up to our responsibility in this crime against those who have been trusting us.

Hot Potato

Insurance men generally insist that no policy is so bad that it needs to be replaced. It was sold by a high-minded insurance man, and he could not make a mistake and advise the wrong policy—and of course he would never deliberately misadvise the client just for the commission involved. That's their story, but in the very next breath they are privately denouncing each other for doing just those things. It's like a western on TV—the agents who put the policies on the books originally and who are drawing lifetime renewal commissions on them are the good guys, and the agents who are knocking the old policies out and replacing them with new policies are the bad guys. It's sometimes hard to tell them apart because the bad guys generally go around pretending to be good guys. Do the insurance men who claim that no policy should ever be replaced mean that the current crop of insurance men is the first that ever had a few bad apples in the barrel?

Robert B. Mitchell, voluble editor of the *National Underwriter*, discussed the problem in that paper, particularly the suggested requirement that the selling agent state categorically whether the policy is to replace existing insurance. Said Mitchell:

> The replacer has everything to gain by concealing the replacement angle. If he admits there is to be a replacement, the home office may ask him a lot of questions and thereby delay issuance of the policy. Maybe the policy won't be issued at all. *Maybe he has a well-founded feeling that the home office doesn't mind getting replacement business as long as it isn't officially informed of its character.*" (Italics added)

The *National Underwriter* for February 25, 1961, reported that at the annual conference of New York State life under-

writers at Saratoga Springs, the problem of replacement had been the chief topic of discussion.

> Not much time was devoted to drawing distinctions between replacements that are in the policyholder's interest and those that aren't. The prevailing opinion obviously was that extremely few replacements are defensible and that even though some of them might be a better bet for the buyer than keeping his old insurance, the result of a bargain-seeking attitude on the business and on the general body of policyholders would be so disruptive that replacements should be discouraged by every possible means.

That's an interesting point of view, don't you think? There is no distinction between replacements that are in the policyholder's interest and those that are not. Even granting that a new term policy with premiums based upon more up-to-date mortality tables would be an improvement over the 20-year endowment that someone stuck the policyholder with a few years back, the companies can't have exchanges being made and people looking for bargains—just imagine what that would do to the industry.

Solomon Huber, general agent in New York for Mutual Benefit Life, complained bitterly (the *National Underwriter*, August 19, 1961) that replacement was undermining the business:

> If you start writing letters to home offices of wrongdoers and raiders about a case, everybody treats it like a hot potato and the companies don't dicker with one another because each can point to the other as having done something. They are also afraid of anti-trust trouble.

Spencer L. Kimball, professor of law at the University of Michigan, and Bartlett A. Jackson, dean of the Michigan Law School, reported in their book *The Regulation of Insurance Marketing* that while it seemed likely that replacement was unjustified in a very large percentage of cases in which it occurred, sample calculations made for them by a competent actuary suggested that there were a surprisingly large number of potential cases in which replacement would be clearly beneficial to the policyholder if the agent of a low-cost company "twisted" the policy of a high-cost company. The authors con-

cluded that on the basis of the computations made for them, it could not be said that "twisting" was never, or only rarely, justified. They expressed the view that appropriate devices should be developed for the control of "twisting" in those instances where it was unjustified.

Obviously, a switch would result in improvement if the change is from a company with high mortality and expenses to one with low mortality and expenses.

In the *Transactions of the Actuarial Society of America,* a member, R. B. Robbins, approaches twisting from a different angle: "Without question, a great deal of life insurance continues in force after the possibility of financial loss to the beneficiary has long since ceased."

Arthur F. Hall, president of Lincoln National Life, advised policyholders against switching: "Some of you will undoubtedly be solicited to drop your insurance. We feel confident, however, that your interests will best be conserved by continuing your policies in force."

Contrast this advice with the contents of a letter written by him to a friend:

> Yes, I personally surrendered $131,000 of insurance for its cash value of $24,000 and replaced it with $150,000. . . . I consider the $24,000 cash value worth 5% to me, or $1200 per annum. The premium on the $150,000 . . . is approximately $1200 greater than the premium I was paying on the insurance I surrendered. However, I have the $24,000 on hand plus $19,000 additional insurance, so I consider that I have increased the value of my estate over $40,000 by the exchange. . . . It is true that an insurable risk has the right to take or drop such insurance as he pleases.

Another expert, James E. Hoskins, assistant actuary of the Travelers Insurance Company, acknowledged that: "Too strong objection should not be made to the substitution [i.e., replacement of policies] when circumstances have changed or when it seems probable that the original insurance was not properly sold."

I imagine Hoskins may have heard from a few insurance men about those last three dirty words.

Having trouble deciding whether your policy is a candidate for replacement? Here's a simple formula the insurance men

have developed to make it easy for you to compare your tired, old policy with a bright new one. We reprint it below just as it appeared in the *National Underwriter*, explanatory note and all.

$$
{}_{t+n}V'_x - \left(P'_x \cdot {}_n u_{x+t} - \sum_{r=1}^{n} {}_{t+r}d'_x \cdot \frac{D_{x+t+r}}{D_{x+t+n}}\right) <
$$

$$
{}_tV'_x + \left(1 - 10^{-3}\,{}_tV'_x\right) {}_nV^2_{x+t} + i \cdot {}_tV'_x \left({}_{n-1}u_{x+t+1} + 1\right)
$$

$$
- \left(1 - 10^{-3}\,{}_tV'_x\right)\left(P^2_{x+t} \cdot {}_n u_{x+t} - \sum_{r=1}^{n} {}_r d^2_{x+t} \cdot \frac{D_{x+t+r}}{D_{x+t+n}}\right)
$$

Mathematical formula for determining whether replacing an existing policy would probably work out to the policyholder's benefit: Valued at the end of the period chosen for observation, using select mortality and an essentially riskless interest rate decreased by income tax for the "outside" investment fund, the cash value of the replaced policy at the end of the period less the net premiums (after deducting dividends) payable during the period must be less than the cash value released at replacement plus the cash value of the replacing policy at the end of the period plus interest on the cash value released at replacement less the net premiums (after deducting dividends) on the replacing policy. It seldom is.

In this comparison the face amount of the replacing policy equals the face amount of the replaced policy less the cash value released at replacement. The formula was exhibited by E. J. Moorhead, actuary of New England Life, in his presentation as a panelist at a discussion of the replacement problem before the annual conferment luncheon of the New York City CLU chapter.

How is the average policyholder expected to be able to comprehend the complexities of a new policy offered as a replacement when the insurance industry itself requires such a preposterously involved formula as this to evaluate the advantages of a switch?

The Association for Advanced Life Underwriting, an organization of agents who claim a better-than-average knowledge of life insurance and how to sell it, queried its members

on how replacement affected them and where they thought it originated. The questionnaire aroused more interest than any activity ever undertaken by the Association. The emphatic tone of the replies and the frank nature of the opinions expressed astonished the industry. Three-quarters of the members have the CLU designation, which means that they have successfully completed an extensive course of study on the nature and uses of life insurance, and are selling more than a million dollars of life insurance each year.

The first question was: "Is replacement a serious problem to you?" Only 5.1% acknowledged that it was a problem; 93.2% said it was no problem, and 1.7% couldn't make up their minds. Surely this is a phenomenon. The trade journals fill their columns with articles and editorials denouncing replacement. Long speeches are made at every convention describing it as a cancer which will destroy the industry. Yet 93.2% of the most experienced and knowledgeable salesmen report that it is no problem.

It is no problem to experienced and knowledgeable salesmen simply because they are the ones principally engaged in the practice. Replacement is no job for amateurs. Development of the elaborate proposals which induce people to give up cash value insurance to buy other cash value insurance requires a rather detailed knowledge of the product.

Spencer L. McCarty, managing director of the New York State Association of Life Underwriters, was quoted in the *National Underwriter* for March 31, 1962, as knowing of "one large company that reports the worst offenders in replacement situations are its career agents, that mutual fund salesmen run a poor second and outside 'insurance consultants' placed third."

The life insurance industry has repeatedly charged that the activities of mutual fund salesmen are the chief cause of the replacement problem, but are they? The members of the AALU were queried on this. To the question "In general, who seems to institute replacement?" 49.2% blamed competing life insurance agents. Only 30.2% held mutual-fund salesmen responsible.

Asked if the life insurance companies themselves had contributed in any way to the problem, 36.5% blamed the contests for volume leadership among agents and companies. Another 27% charged that the companies had aided and

abetted replacement by issuing dividend illustrations "which project net costs never yet achieved by the issuing company." Another 27% blamed the companies for discriminating against old policyholders by issuing "specials" or loss leaders. To 22.2%, the failure of old policies to reflect current interest earnings and mortality savings was a factor in replacement. A fifth of all agents replying also noted a "lack of agent training and field development."

A total of 12.7% of the agents queried felt that "client's professional advisors" were responsible for the shifting of insurance policies, and 39.7% of the group concluded that the solution should include legislation levying penalities against persons not licensed as insurance agents who provide insurance advice. This would make it a criminal offense for a lawyer, friend, or trusted advisor—no matter how much he might know about insurance—to give you any information and advice which might result in your changing your insurance policy to one more suitable to your circumstances and needs unless he was an insurance agent.

Here's a selection of excerpts from the revealing responses to the questionnaire on the problem of replacement:

"I don't believe there really is a problem. This is a cover-up for company failures to meet its social obligation to its policyholders."

"The main problem seems to lie with the unconscionable agent who is interested in making a sale regardless of consequences and needs within the ability to pay."

"I don't believe that business morality can be legislated. Any attempt brings the government closer to our business. The government is too close already."

"Actually, many agents are not familiar enough with the mathematics of life insurance to know that they are hurting the client."

"Stop giving out licenses to everyone who can sign his name. Stop all false advertising by agencies and companies about estate service, personnel, etc., and limit such to only the truly qualified."

"As many people are injured by not having their insurance replaced as are those who do have their insurance replaced."

"It appears to me that the man who has four children and is spending $400 to $500 annually on endowments for education and only $200 annually on insurance on his own life has been injured at least as seriously as he would be by a 'replacer.' "

"Insurance has offered no protection in terms of human needs for purchasing power and honest counsel based on needs rather than commissions and a brainwashed conviction that life insurance is the best investment for most people."

"Life insurance selling is not a profession. It is a competitive business. We are not lawyers or doctors. Insurance companies are in business to make money."

"I don't feel the 'replacement of insurance' is very much the concern of the AALU. Discussion with any company actuary will reveal that there is a definite difference between the mortality experience on old policies and the mortality experience on newly insured lives. It is mostly a concern of the life insurance companies who do not wish to give up a windfall which they get by maintaining existing policies on still insurable lives."

"Let us take a representative company's policy plan and let us not confuse it with dividend schedules, which are extremely hard to come by. At the end of 1940, a 25-year-old could buy a $100,000 policy from the X Company for an annual premium of $1656. The premium was the same for male and female. In 1960, this same policy had a cash value of $23,050 or a paid-up value of $45,680. If this insured decided to stop paying premiums and take his (or her) paid-up value, he (or she) would need $54,320 in order to have $100,000 as before. According to the published rates of X Company, a male age 45 could purchase $54,320 [of insurance] for an annual premium of $1511.08 and a female age 45 could buy it for $1344.31. This reduction in premium income may be uncomfortable for X Com-

pany but it is not detrimental to the insured and not detrimental to the agent who sold the new policy."

"The problem lies within the companies themselves. If the companies added an additional option to permanent plans, the right to convert to term at the insured's age at issue, refund the reserve and accumulated dividends, if any, they would retain all policies on the books."

"The type of replacement which is causing the widest concern at this time is connected with the dual nature of life insurance contracts. Firstly, it is an insurance policy. Secondly, it is an investment. Wherever this order of priority is reversed, you are asking for replacement.

"I sell the concept of insurance. I do not use an investment illustration as a sugar-coated pill to get a man to buy the protection which is vital to an orderly financial program. Now any other medium of investment allows the investor to make adjustments as conditions change. We are now talking about sophisticated people who are quite capable of managing their own affairs. Likewise, they are capable of judging the validity or otherwise of advice that may be offered them.

"Only the life insurance industry of all the fields of investment says to the investor: Once you take a contract with us, it is sacred—you must never change it or give it up on the pain of financial penalties. Furthermore, anyone who advises you to make such a change is by that very advice branded a malfeasor and subject to legal penalties.

"This is pure nonsense. A man has the duty to review his investment portfolio from time to time and to make such changes as he deems to be in his best interest. The penalties built into the insurance contract to prevent such changes merely are one more factor that he must consider when making up his mind. If, on balance, he feels the change will benefit him, he makes it.

"The insurance industry by and large has set up a gigantic tie-in arrangement whereby a man cannot purchase permanent insurance without investing his own reserves. To the extent that this is called for by rising mortality charges as a man grows older, there is no help for it.

"However, around this actuarial fact the industry has erected its investment structure. The picture has been so

distorted that the investment features, instead of being incidental to a soundly worked-out program of insurance, have become the central feature of the entire arrangement.

"That insurance should consequently be reviewed from the point of view of its investment value follows naturally from the above. Any attempt to keep the investor from making such changes as his business judgment indicates is simply fatuous.

"If the insurance industry wants to be competitive in the investment field, let it offer competitive merchandise—not depend on trying to dictate to its policyholders. No agent could replace a policy unless the policyholder felt that it was in his best interest. In my opinion, malpractice on the part of the field force is responsible for a very minor part of replacement business.

"Rightly or wrongly, foolishly or wisely, the investing public is turning to other media for long-term investments and is insisting that the insurance industry provide more insurance and less investment in its offerings. This is the heart of the so-called replacement problem. The rest is hot air."

The noted economist, Roger Babson, illustrated the value of a careful rearrangement of personal insurance with this story about a client of his firm:

At the age of 28, the client took out $10,000 in a 20-payment life policy with one of the best American companies. At the age of 48, this man had the policy paid up and thereupon the premiums ceased. He then had $10,000 of insurance in force and was very happy at not being obliged to pay any more premiums. However, we called his attention to the fact that the cash value of his policy today is $5340 which, invested at 6%, would give him $320 per year. We also pointed out that if he can pass the physical examination, he can purchase a new ordinary life policy of $10,000 from the same company for an average annual premium over 20 years of approximately $317 per year. This means that by cashing in his policy for $5340 and investing it at 6% and using the income to pay the premium on $10,000 of ordinary life, he would, if he died next year, have $15,340 instead of $10,000 as would have

happened if he had simply let his 20-payment life policy run.

There are probably thousands of cases in the country similar to this, in each of which the insured probably could improve his position by some form of conversion.

With all the talk pro and con, replacement goes on. A vast amount of new business being written is just old business being rechurned by the gentlemen with the rate books. Five million dollars of business goes off the books of Company A and Company B, and promptly reappears on the books of Company C as new business. Against it must be levied all the commission and other costs of new business. The new premiums collected in the course of putting it on the books do not cover the costs of its acquisition by Company C. The deficit is charged to surplus and is reflected in sharply lower dividends to the company's older policyholders.

"Older policyholders." That's you and me.

Naturally, the agents most hurt by the replacement are those who have been reaping the biggest harvest of commissions from sales of high-premium policies. It is a simple matter for the replacer to show the policyholder the inequity of these investment-type policies which were sold with little regard for the best interests of the insured. It is amusing to hear the wounded companies and agents demanding a policy of "complete disclosure" on all proposed replacements. They want a regulation requiring replacers to give a detailed, written prospectus on all switch sales.

Why stop there? Why not insist upon full and complete disclosure *at all times* and *on all sales?* Since these companies and their agents are so anxious for full disclosure on these policies, why do not the state insurance departments take the opportunity to overhaul the existing merchandising methods of the life insurance industry and introduce a system of complete disclosure at all times?

Chapter 31

Knox–Anderson

For a long, long time the life insurance men of the country have rolled along without worrying too much about rules and regulations, doing untold damage in the lives of their fellow men. No one has ever held them to account.

Now, however, all that is changing. Two words now strike terror into the heart of every insurance man. Those words are "Knox–Anderson."

In 1958, in the case of Knox vs. Anderson, a federal district court in Hawaii found for the plaintiff in an action brought by a policyholder against an agent of New York Life who had sold him bank loan insurance (now more popularly known as minimum deposit insurance, and described in Chapter 16).

The defendant, J. Leland Anderson, was an insurance agent with some 25 years' experience who for eight years had specialized in bank loan insurance. The plaintiff, Robert I. Knox, aged 38, was a field superintendent of a sugar plantation on the Hawaiian island of Maui, some 70 miles from Honolulu. Knox was married, the father of three children. He had an annual earned income of $8100 per year and an investment income of $1500 per year.

Knox claimed that Anderson, assisted by another agent whom the court described as a "bird dog," had approached him with a proposal for a bank loan plan involving the issuance of a $100,000 insurance policy with an annual premium of $7265. This to a man whose earned income was $8100 per year. Through policy loans on a number of old policies he owned, Knox was able to obtain the money to pay the first premium on the new policy. He was then permitted to post the policy as collateral for a loan to help pay the second premium. In each subsequent year, he was to borrow the increased loan value of the policy to help pay the premium for that year. A projection of future dividends aided in creating an impression of low net cost to carry it. Knox accepted the recommendation as coming from an expert on whose

opinion he was entitled to rely. Anderson later returned to the island and sold a $50,000 policy of similar type to Mrs. Knox.

Within a year, Knox concluded that he had been misled and the policy's advantages misrepresented to him. Receiving no satisfaction from New York Life, he finally sued Anderson. To the astonishment of the life insurance industry, he was awarded $25,809 for out-of-pocket loss, mental suffering, and punitive damages.

The life insurance industry was shaken at this evidence that it was possible for a wronged policyholder to seek and obtain damages. It regarded the decision as a freak, however, and confidently expected Anderson's appeal to the Ninth District Circuit Court in San Francisco to set things right.

On December 4, 1961, the bombshell came. The appellate court sustained the lower court by unanimous decision of the three judges. The appellate court drew attention to the testimony in the lower court on the question of whether Anderson had recommended a plan of suitable size and type to Knox and his wife:

> *The Court:* Let's go over it again. From the answers you have given me, I take it that you are saying, no, that you felt that you owed them no duty to protect them against any bad judgment that in your opinion might be exercised in relation to the insurance they had decided to purchase?
>
> *The Witness:* I guess that's right, with this qualification—that it was their responsibility to determine what they should buy and could buy. I was selling life insurance. But at the same time I felt that I was using the judgment of the insuring company in the amount that would be issued. As to what they decide, what they should buy, it's their responsibility.

Said the appellate court:

> We believe that this answer alone would be sufficient to warrant the trial judge in finding that Anderson, in making his representations respecting the suitability of the program, did so with reckless disregard as to whether his representation was true or false.
>
> In this same connection, Anderson's testimony is that he did not undertake to draw up a suitable program of

insurance for the Knoxes. "I didn't do any extensive planning because that was not my field. I simply submitted policies that were applied for and they made the decision as to what they wanted to purchase." He did little personally to inform himself as to the facts relating to Knox, his income, his resources, and his old insurance program before he undertook to sell the plan to him.

This complete detachment is consistent with other circumstantial evidence in the record. Kreidler [Anderson's associate] testified that he had attempted to argue with Anderson that the $100,000 policy was more than Knox could afford. He was told by Anderson that he, Anderson, would make that decision; but Kreidler went on to explain that one reason why he could not get along with Anderson, one point of difference with him was that he did not believe in over-selling people who could not carry large amounts of insurance with large premiums. He said it was Anderson's practice to determine the size of the new bank loan policy by ascertaining the total amount of cash values and dividends in the purchaser's old contract. The question was: What would those old contracts pay in the way of premium? That this was the circumstance which actuated Anderson in selling the program can be inferred from the fact that after Anderson's first contact with Knox in November, 1952, it developed that Knox had other insurance with additional cash values. With this knowledge Anderson proceeded to sell the policy on the life of Ellen and the additional loan values were plowed into the new premium. It was then, as we indicated above, that the total amount of insurance was raised by another $50,000.

In a separate, very short concurring opinion, Judge Chambers said:

I regard it as a reasonable inference that the multiplicity of figures given to Knox were not intended to enlighten but were intended to put a film of sweet lusciousness over the shell of a bitter coconut.

Concluded the court:

It is apparent that a mere look at the characteristic fea-

tures of the plan is sufficient to make it apparent to anyone, and particularly to the trial judge, that it contains within it features which make it inherently a system readily adaptable to sharp practice.

The first weakness of the plan is its built-in temptation arising out of the inflated commissions. The trial judge could justly raise his eyebrows in observing the temptation to over-selling involved in what he could properly consider to be excessively large commissions.

The excessively large commissions on the policies were not set by agent Anderson. They were set by New York Life, which certainly must bear its share of onus for the attempted financial rape of the couple in Hawaii. According to the *National Underwriter* (December 16, 1961):

> The appeals court's willingness to go along with the mental suffering award stemmed in large measure from Mr. Anderson's recommendation to New York Life, of which he was an agent at the time of the sale, that it should not give the Knoxes any special consideration in letting them give up the policies he had sold on the bank-loan plan.

Editorialized the *National Underwriter*:

> If an agent can be held liable for recommending and selling a plan that is "unsuitable" because of being too much for the buyer's means, how about the recommendation and sale of a plan that is poorly designed in the light of the buyer's situation? For example, what about the sale of a high-priced educational endowment policy when the prospect's real need is for coverage to enable his wife and youngster to get along if he should die before the child reaches college age? And there is the situation where the prospect asks the agent, "Do you really think this is the best policy I can buy?" and the agent answers "Yes," even though he knows that Ajax Life has a similar policy with more liberal provisions and a lower cost. When the agent says "Yes," it is a dishonest opinion, but presumably the difference in cost and benefits between the policy he is pushing and the best that could be had is small enough so that, by itself, it wouldn't make a suit worthwhile.

The appeals court has said, in effect, that a prospect is entitled to rely on an agent's recommendations if he gives an impression that he knows what he's talking about; that opinions, even though wrong, must be honestly arrived at and that concealing material facts in a sale constitutes misrepresentation just as much as an outright lie—and that failure to live up to these standards subjects the agent to liability for any resulting loss to the buyer.

In its issue of February 10, 1962, the *National Underwriter* front-paged a story by Harold Franklin, national president of the Association for Advanced Life Underwriting, headed "Knox–Anderson Decision Called Threat to Established Practices." Said Franklin:

. . . the more I studied the case, the more I began to differ with the court's implied denunciation of practices which have long been accepted in our industry. Like everyone else, I wonder where this is going to lead.

All of us have been taught to obtain referred leads, and if possible, letters of introduction. All of us have been taught that we should present a picture of confidence—that we should make the prospect believe that we have the answers to his problems. All of us have been in situations where we had to appear to know more than we did.

The line of demarcation between "puffing your wares" and unethical misrepresentation has not been drawn. Until this line is drawn, we can expect to see many suits, deserved or otherwise, settled for a price so that the agent will not be subjected to notoriety and expenses of litigation.

Let's not for a minute expect that these nuisance cases will be limited solely to minimum deposit and financed insurance situations. We're going to find unhappy and disgruntled policyholders among those who expected their 20-pay life policies to be 20-year endowments and others when the dividend schedules do not live up to the optimistic projections.

Agent Anderson appealed the decision to the United States Supreme Court, which on June 11, 1962, refused to review the case.

Nemesis

And so, at long last, a breakthrough.

The sins of the insurance fraternity are now starting to catch up with them. For three generations, they've played fast and loose with the financial security of the American people. Millions of unsuitable policies have been sold only to be abandoned when their disillusioned owners realized their mistakes or when the burden of excessive premium charges had grown so great they could no longer be carried. They remained on the books long enough for the agent to collect his commission, and went off the books at a loss in the billions—including a surrender charge to the company. Phoney dividend projections, phoney net cost illustrations, complex bank loan plan and minimum deposit illustrations calculated to put "a film of sweet lusciousness over the shell of a bitter coconut"—these are the tools the insurance fraternity has used to line its pockets with other people's money. These are the evidences of "a system readily adaptable to sharp practice."

Now they sit trembling in their offices, whining that the things of which they have been found guilty have long been the accepted practice in their industry. Now they nervously go through their file cards, wincing at the bank plans and the 20-year endowments they sold to men with large families and praying that a divine providence will save them from being a principal player in one of the ten thousand courtroom dramas that the Knox–Anderson decision will certainly inspire.

Three of the largest companies and five of their agents are being sued for $420,000 in the California state court at Siskiyou on charges of misrepresentation in the sale of minimum deposit plans.

Robert E. Dineen, vice-president of Northwestern Mutual Life, discussed the implications of the Knox–Anderson decision before the Chicago Association of Life Underwriters:

> This authoritative decision, buttressed by visible evidence of legal scholarship and life insurance research, stands out like a beacon in misrepresentation cases for policyowners and agents alike. It is a precedent for future generations of policyowners who have been deceived by faulty sales

presentations. It is a warning to agents of the perils which flow from the failure to present the facts fully and fairly. There is no doubt that this decision will help keep some of our more venturesome agents honest.

The *National Underwriter* observed that the decision was a symptom of a changing climate in which life agents may expect to be held to a higher duty than merely that of not actively misrepresenting.

Vice-president David Hoxie of National Life of Vermont told the company's general agents:

> Unquestionably, Mr. Knox's success in his litigation against Mr. Anderson will result in other purchasers of life insurance bringing suits against the selling agents on the grounds that the proposals on the basis of which the purchases were made were not suitable to the needs of the purchaser. Already, in my own experience in the National Life, I have seen at least two situations in which threats of such litigation have been made.
>
> It is my personal guess that on the same or a similar state of facts, the other courts will find in favor of the insurance purchaser and against the soliciting agent.

The *National Underwriter* editorially mourned the decision and the higher standards which it appeared to force upon the sellers of life insurance, saying:

> The problem is that if you impose professional standards too widely and too fast, you interfere needlessly with the sale of a lot of life insurance that families badly need.
>
> It would be a pity if too-strict professional canons should slow down the sales process in the absence of excellent reasons for it—reasons which we do not believe exist.
>
> A gradual evolution toward more professional standards in life insurance selling—and all other kinds of selling, for that matter—is a fine thing. But an artificial push, like an unwise application of the standards apparently set forth in the Knox–Anderson decision, could stall the sale of a lot of life insurance by agents made gun-shy by the threat of being held liable in damages.

Sit down tonight and go over your insurance policies carefully. If you know or suspect that you've been had, take your policies to your lawyer tomorrow and invite him to read this book and then read your policies. He'll know what to do—unless, of course, he's one of those lawyers whom the *National Underwriter* editorially claimed have been taking under-the-table payments from the agent for advising you to buy the policy in the first place. I don't think that you are likely to find too many of *them,* though.

Remember, it has now been established judicially that if an agent represents himself as an expert on insurance, as a "consultant," you can hold him liable for selling you an "unsuitable" policy. If he fails to inquire into your circumstances and/or deliberately sells you a policy with a premium obviously beyond your means, you can hold him responsible for any loss you suffer on that account. If you tell him that you want the most protection for your money and he fails to advise you of the availability of term insurance—and instead sells you cash value insurance, you have a claim against him.

If you have bank loan or minimum deposit insurance, dig out that elaborate sheet showing payments, interest charges, dividends, etc. Have a photostat made and send it to the insurance commissioner of your state and ask him if the proposal was true and correct or if it omitted any material facts. If it included a column projecting future dividends, note particularly whether the proposal contained a hedge clause explaining that dividends were neither guaranteed nor even estimates. If you have mislaid the sheet given you by the agent, write him that you'd like another so you'll have a schedule of the payments you are to make in future years. You probably won't get it—by now, he's running scared—but have a go at it, anyway.

Tonight, a lot of "underwriters" are on their knees praying hard and promising that if they get out of this mess, they'll never, never sell another minimum deposit plan or educational endowment.

Chapter 32

Airing the Subject

At the invitation of the Columbia Broadcasting Company, I presented a series of estate-planning discussions on a program conducted by Bob Dixon, regularly heard over the network's principal outlet, WCBS in New York.

Because of that station's enormous audience and the fact that the life insurance industry took offense at some observations about its product, the subject got a rather wide airing.

I am glad to give the Institute an opportunity to be heard with its side of the story. Following is a transcript of that portion of my talks dealing directly with insurance, and the Institute's reply.

Dixon. Mr. Norman F. Dacey, President of Norman F. Dacey & Associates, Inc., in Bridgeport, Connecticut, nationally known specialists in estate planning, came by to talk to us about insurance and planning for our futures. Now, this is something that is vital to every family, and there are a lot of us that really aren't too sure about insurance and investments, and what is just right in each individual case. So I asked Mr. Dacey just why people buy life insurance, which is an obvious question, and he said:

Dacey. Presumably, men buy life insurance to provide protection. That was its original intent and purpose. However, it has come to be widely misused and the majority of people no longer buy it just to provide protection. They are led into buying it as a savings or investment program. They use it to accumulate funds for educational purposes, to buy a home or to pay off the mortgage on one they already own, or to retire on at 65. Life insurance was never intended to do any of those things. It was intended simply to provide protection. When you insure your house, you give the insurance company just the cost of protecting you. You don't give them any extra money and say, "Here, hold this for me, and give it back to me in twenty years, or when I'm 65 or 96." When

you insure your car, you give the insurance company just the cost of the protection and not another penny. After all, it's an insurance company, and not a savings bank. But when people buy life insurance, they generally give the company not only the cost of the protection, but some extra dollars as well, which the company is to hold and give back to them at some date in the future.

DIXON. These can be called endowment policies and such?

DACEY. Well, life insurance is divided into two main types. Term insurance is pure protection—like the insurance on your home and on your car. The other kind of life insurance is simply a combination of reducing term insurance plus a savings account which matures at some agreed date in the future. If you own a 20-year endowment it matures at the end of 20 years. If you own a retirement-income-at-65 policy it matures at age 65. A whole life policy generally matures at age 96 or 100. In other words, it's a combination of protection—term insurance—plus a savings account which matures when you're age 100. You have to be pretty much of an optimist to expect to live to collect that savings account. I don't believe that you'd go into a savings bank and say, "I'd like to open a savings account. I'll be down to get it when I'm 96 or 100—and if I die before that you can keep it." You wouldn't do that with a savings bank, and yet that is just exactly what you do when you buy a whole life or ordinary life or straight life policy—all different names for the same thing. You give the insurance company the cost of protecting you, plus some *extra* dollars to put into a savings account that will mature when you're 96 or 100. And if you die before that, the company uses your savings account to help pay the claim.

To put it another way, they pay your family the thousand dollars for which you gave them the premium that year, but they keep your savings account. Let's assume that you buy term insurance—which is pure protection—and put the difference between that smaller premium and the larger premium required for the whole life policy into a savings bank. You can go down to the savings bank after five years or fifty-five and take your cash value out of the savings bank, and you'll have much more cash value. For one thing, the insurance company pays out 15% of everything you pay into that policy in your lifetime just for selling it, including 15% of the savings account. If you buy term insurance, the com-

pany will pay the agent a commission for selling it to you. But the savings bank won't pay anyone a commission for selling you the savings account. Your money will be added to, nothing will be taken from it. Incidentally, the savings bank will pay you a higher rate of interest than the insurance company will, so whether it be five years or fifty-five, you will accumulate more cash value that way. If you live, you'll be better off. But what happens if you die? Your family will have all the life insurance and all of the money in the savings bank. They will have both, instead of the insurance company using your savings account to help pay the claim.

DIXON. Let's take an actual situation; let's assume a man buys a policy for, say, $5000 of a savings-type of insurance. Can you tell us how much he will have put in by the maturity date, and how much he will get back? Does it just about even out?

DACEY. Yes. In fact, the insurance company will tell you that if you hold the policy long enough, the insurance protection will have cost you nothing. The interest on your money will have paid for the protection and you will get all of your money back. They just don't take into account that if *you* had had that money all those years and *you* had gotten the earnings on it, you'd have a handsome profit instead of just breaking even. Of course, there isn't too much profit in life insurance. It isn't intended to be an instrument for the building of an estate. It's supposed to provide an estate for your family if you don't live long enough to accumulate the estate yourself.

DIXON. That's right.

DACEY. Let's assume that you have a $5000 whole life policy which you took out at age 35. You're now age 65 and your policy has a cash value of $2000. That is *your* money. Those are the *extra* dollars that you need never have given to the insurance company, but you elected to do so. If you die now, at age 65, the company will add $3000 of *its* money to *your* $2000 and pay the $5000 total to your beneficiary. Actually, then, you have $3000 of insurance. The other $2000 is your own money.

If you have a 20-payment life policy, the contract provides that you pay premiums for a limited period of time—20 years—instead of spreading your payments over your whole lifetime. At the end of that time, the policy is said to be paid up. Actually, there is no such thing as a paid-up policy. If

you have a 20-payment life policy which is "paid up," it has a cash value of perhaps $600 for each $1000 of insurance. Now, if *you* had that $600 and invested it and got, say, 6% return, that would produce $36 per year income. But you *don't* have that cash value. The life insurance company has it, and it's investing it and it's getting the return. So it's really costing you $36 to keep that policy going; the $36 *you* would earn if the money was in *your* name rather than in the insurance company's name. What are they giving you for the $36? Well, if you die they will pay your family $1000. If you ask for your money they'll give you the $600 cash value. So what you're getting for your $36 is the $400 difference, the amount that they add to your cash value to make up the face amount. You're paying $36 for $400 of life insurance, which works out pretty close to $90 per year per thousand—which is hardly paid-up insurance.

The insurance companies claim, of course, that if it weren't for the premium notices they send, no one would ever save any money. While this may well be true of some persons, I think that they are a minority. In any case, there are now many ways of saving money which have an element of assistance in them. There are, for example, mutual-fund investment programs, where a bank will send you a reminder each month just as the insurance company does. It comes in between the telephone bill and the light bill and it gets paid automatically, just as the insurance premium was, and you end up by having accumulated something. The great difference is that the money has been put to work for your benefit rather than for the benefit of an insurance company.

* * *

The broadcasting company advised me that within four minutes of the time I went off the air, the Institute of Life Insurance was on the telephone demanding equal time to reply. Holgar J. Johnson, president of the Institute, spoke on the life insurance industry's behalf. Here is a transcript of his broadcast:

* * *

DIXON. Today, our subject is insurance. This is a very important subject and one I'm sure quite a lot of you have questions about.

I would like to introduce Mr. Holgar Johnson, President of the Institute of Life Insurance, who has all the answers to your questions. Welcome aboard, Mr. Johnson.

JOHNSON. Mr. Dixon, I welcome this opportunity to present a few facts about life insurance, particularly as it affects individual families, and especially in the light of what was presented last week by Mr. Dacey, when he was your guest. I'm not going to dwell on his several inaccuracies, such as the statement he made about the fact that it costs 15% of the over-all of the policy for selling it, because actually, the fact of the cost is, it runs about 7½% for the whole industry and as low as 4% in some instances. But what I am concerned about is some of the over-all impressions that were left, because they could possibly create serious harm for many families and policyholders. Now, he did, of course, say that the primary purpose of life insurance was protection, and of course this is true. But when he suggests that it should not be used to build an estate or to use the reserves or cash values for such emergencies as children's education, or to retire, I'm inclined to believe that he is a little overboard, because of my own personal situation. I've used it, as millions of others have, both for the education of my children, and other purposes as well. Then, of course, he brought up another question which I think I'd like to discuss for a moment. That is the difference between using what is commonly known as term insurance, which is short-term protection, as against permanent insurance, and if you use term insurance, then you invest the difference. Now, incidentally, of course, term insurance has a place in the scheme of things. If it's in its proper place, then it should be used, but when it comes to discussing how you can get the best value out of your lifetime protection, that's an entirely different situation. Now, he used a hypothetical situation the other day. I'd like to use a specific situation from my own life insurance program to illustrate the point.

DIXON. Please do.

JOHNSON. Included in my own life insurance estate—and please notice I used the word *estate*—which is reasonably substantial, I have one policy which can be used, I think, to illustrate the point we are talking about. And to be specific, it is policy #567277. It's an endowment policy at 75. Now, this costs about 11 cents a thousand more than if it was a full-life policy, which is sometimes called a whole life. It was

taken out in 1929. I was then age 32. It's been in force 32 years and it's for $5000, which is a type of policy I think is easy to illustrate.

Now, over the years I've paid a total premium, total amount of insurance premium, of $3155.60, but today, the cash equity value of that policy is $3345.70, or $190.10 more than I paid in for it. Now, this reserve value stands there as an emergency in case I ever need quick cash, and being like most people, there have been times when I have needed quick cash. But all this time, you see, I've had $5000 worth of guaranteed protection for my family, and in fact, it's still worth that if anything should happen to me. Now, I'd like to suggest that you can use a figure of 3%, 4%, 5%, or 6% interest, whichever you want, as the amount of money I have lost by keeping it in this life insurance policy, but the fact of the matter is, whatever the figure is, it's worth more than that to me, because I got the protection for my family. Now, if I follow Mr. Dacey's advice, I should withdraw this $3345.10 now and invest it, but if I do, it will have to increase over 50% in the next few years to be worth that $5000 guaranteed to my family—or to me at 75.

Now, 75 is a long way off, but it will be worth that to me. Now, let me see how this would work out if I had followed his advice and bought what he suggests—term insurance—instead of permanent. Now, over this period beginning at '29 and using a five-year term policy, the premium would have started in 1929 at $45.20 a year and increased each five years up until 1959, when it would have been $175 a year. The average over the period would have been $82 each year. My present policy has had an average of $98.61 a year. Now, with the term, all I would have had would have been $5000 protection. With my present policy, I have $5000 guaranteed protection, but I also have that emergency reserve of $3345.10.

Now, let's assume that my need for life insurance protection was over and I wanted to withdraw this $3300. The difference would be that the term contract would have cost me $82 a year and I've got nothing to show for it but the insurance protection at the end of the period. On my permanent policy, I'd have the same protection and I've got a profit of $190 over and beyond what I paid for it. But that's only part of the story.

Now, if I'd known that I was going to live and I'd been

wise enough to invest these premiums of $98.61 every year with regularity, and never lost anything or invested in the prices of securities in the 30s or the 40s, it might have been worth a lot more—but you see, I didn't know I was going to live. I hoped I would, but my family needed that protection. Secondly, I didn't have any more confidence in the market than most people did. Thirdly, during that period many of our corporations didn't pay very much in dividends. As a matter of fact, U.S. Government Bonds in the majority of the period only paid about 2½%. Now, I wouldn't suggest that everybody use my formula for building an estate for his family. Some might be able to buy term and invest the difference, but I'd like to remind them that if they do: (1) it could cost them and their family more in the long run; (2) they have to keep in mind that even the most successful investor will tell you that you have to count on the possibility of some losses.

Now, if an individual wants to take these chances, I have no quarrel with him. Let him go ahead and take them. My thesis is that my life insurance is a permanent-protection program for me and for my family. Now let me use another illustration, if I can. You see, this isn't the first time, nor it won't be the last time, that these easy procedures will be suggested. For instance, in 1928 I took over a life insurance agency in Pittsburgh. It had about $7 million of insurance in force in that agency. About one half of it or $3.5 million of it was this so-called 5-year term and 10-year term that was purchased in the late 1890s and early 1900s, and most of the people who had that came and complained to me. They were older. Their income was substantially less. The cost was burdensome, but they couldn't afford to let it go because of the fact that they still needed the life insurance protection. They were critical because they hadn't been sold permanent coverage. So, in conclusion, all I want to say is that anyone, of course, can use any program he wants to. He doesn't have to follow my particular procedure, but I do want to say that if anybody needs permanent protection, it's dangerous to use short-term limited life insurance and invest the difference because for most of us, it's a wonderful theory, but it doesn't work in fact.

DIXON. Well, thank you very much, Mr. Johnson.

* * *

I wrote Johnson as follows:

MR. HOLGAR J. JOHNSON, President
Institute of Life Insurance
488 Madison Avenue
New York, New York

DEAR MR. JOHNSON:

I am flattered, indeed, that the life insurance industry selected you, its most articulate spokesman, to present the industry's comments on my recent broadcast discussion of life insurance.

Since you devoted most of your discussion to the theory that term insurance is something to be avoided at almost all costs, may I offer these observations on the subject?

You lumped together whole life, endowment, 20-payment life and retirement income policies in a classification of "permanent" insurance. I've never been able to understand why a term insurance policy taken out at age 30, which runs through until the need for insurance no longer exists at age 65 or 70, is any less "permanent" than a 20-year endowment policy taken out at the same age 30, which expires at age 50.

Also, I marvel at the reasoning which labels as "permanent protection" these policies which consist of an *increasing* savings account and *decreasing* term insurance. If the protection is reducing each year until it finally disappears completely, how in the world can you call it "permanent protection"?

As you know, any cash value you get *out* of a life insurance policy simply represents a *part* of the extra dollars which you need never have put *into* it in the first place. Term insurance is the protection part of all life insurance, and an argument against term insurance is an argument against life insurance itself.

You illustrated your discussion with a description of a $5000 endowment at age 75 policy which you yourself took out in 1929. You told us that it now has a cash value of $3300. That's *your* money, *your* savings account, the *extra* dollars which you need never have given the company in the first place. If you had bought term insurance and put what you saved on premiums into a savings bank, you

would have a good bit more than $3300 cash value now because the savings bank wouldn't have paid anyone a commission for selling you that savings account—whereas the insurance company *did* pay a salesman a substantial commission for selling you the idea of accumulating the cash value. I see no justification whatever for paying a salesman a fat commission to sell me a savings account which I can get in a savings bank or in U. S. Savings bonds without paying anyone a commission, particularly when these latter accounts will pay me a higher rate of interest.

You made much of the fact that *in addition* to the $5000 protection which your family enjoyed, you now have this $3300 emergency fund which you can call upon at any time. Now, I'm all for having an emergency fund—but if you want to use your emergency fund on which you are presently receiving something less than 3% per year interest from the insurance company, the company will lend *your own money* back to you at 6% interest! Doesn't that seem silly—borrowing back your own money for twice the rate at which you are lending it? If you had bought term insurance and accumulated your cash value separately in a savings bank, you could now go down to the bank and draw out your $3300 and you wouldn't have to pay anyone 6% for the use of it.

Let's suppose that you find that you *do* need the $3300 emergency fund which you told us the insurance policy supplied *in addition* to the protection. Let's assume you take it out—and die next week. The insurance company will deduct the $3300 from the $5000 it has contracted to pay your family—and your beneficiary will receive only $1700. If your $3300 emergency fund had been accumulated in a separate savings bank account—and you had now withdrawn it—you would owe the insurance company nothing. They'd have to pay the full $5000 to your family. Borrowing from the insurance company, you have ended up paying more premium for less insurance, because now you must pay the regular premium plus $198 of interest at 6% on the "loan" they made to you of your own money, while your insurance protection for your family has shrunk from $5000 to $1700.

In your talk, you warned your listeners that at the older ages, term insurance would cost more than your endowment policy. You said that if you had bought term insurance

and renewed it periodically, you would now be paying $175 per year premium for the $5000 of protection. That's $35 per year per $1000. As it is, if you die owning your endowment policy, the company will add $1700 of its insurance to your $3300 cash value and pay the total to your family. For that $1700 of protection which the insurance company is now providing, you are by your own admission now paying a premium of $98 per year. That's $57 per year per $1000. Which is cheaper—$35 per year per $1000 or $57 per year per $1000? Your endowment policy premium is less than the premium would be today for a $5000 term insurance policy simply because it is providing only one third the protection that the latter would provide. I don't believe you deliberately intended to mislead the millions who were listening to you. Still, it's hard to believe that the president of the Institute of Life Insurance didn't understand his own policy and how it worked.

We both know that you understand *exactly* how your policy works. With that understanding, you nevertheless made a public explanation which left millions of people with an incorrect understanding of the facts.

In your talk, you repeatedly inferred that the alternative to your high-premium cash value insurance is *no* insurance at all and quoted me as suggesting to people that they shouldn't buy life insurance but should invest the premium money. I didn't say that at all, of course. What I said was that they should buy maximum protection at minimum outlay, and do their saving and investing somewhere else.

Every year, thousands of Americans die and leave their families inadequately protected simply because they wasted precious premium dollars buying savings accounts from insurance companies.

You spoke of "inaccuracies" in my discussion of insurance, mentioning specifically my figure of 15% of the total amount paid in as the cost of selling a policy. That figure was obtained from your own Institute of Life Insurance five years ago; if it is not correct, I am sorry. Since your broadcast, I have examined the statistics presented in the current *Life Insurance Fact Book* which your Institute publishes. I find that in the calendar year 1960 an amount equal to 25% of total premium income was paid for "direct field compensation." It would appear, then, that my figure may have erred on the conservative side.

Repeatedly in your discussion you stated that your policy provided you with $5000 of protection *plus* a $3300 emergency fund. You know, of course, that this is not so. It provides $1700 of protection plus a $3300 emergency fund. Why do you persist in publicly describing your $3300 emergency fund as "protection"? If this is "protection," then so is your savings account, your checking account, savings bonds, your investment holdings, even the home you own. If your $3300 savings account with the insurance company can properly be labeled as "protection" then so can all other property of which you may be possessed. I am sure that you will agree that this is a tortured interpretation of the word "protection."

Insurancemen insist that they sell "cash value" life insurance because it is the kind of insurance which they honestly and sincerely believe the public should own. I say that this is a sanctimonious untruth—and here is the proof, not in my words but in the life insurance industry's own words. I have before me a copy of the December 15, 1959, issue of *Forbes* magazine which features an interview with Charles E. Becker, president of the Franklin Life Insurance Company, one of America's most successful companies. I quote:

> To get top earnings for salesmen and stockholders, Becker concentrates on the more profitable kinds of life insurance. For example, the biggest volume gains for most companies have been in group insurance, but profits in this line run about one-third of those on ordinary life. Franklin stopped selling group five years ago. Franklin Life now ranks as the U. S.'s largest writer of ordinary life alone. "Why do we write only ordinary life? *Because that's where the profit is,*" grins Becker. "With the high premium policies in which we specialize, I can afford to pay our agents top commissions and still generate high profits for our stockholders."

Why do you and your insurance colleagues urge the public to avoid low-cost term insurance and instead buy high-premium cash value insurance? Because, as Mr. Becker says: "That's where the profit is."

Very truly yours,
NORMAN F. DACEY

Chapter 33

National Service Life Insurance

THERE IS NO insurance privately sold in America by legal reserve life insurance companies which can be purchased on as favorable a basis as National Service Life Insurance, the "GI insurance" owned by nearly six million veterans.

An earlier version, known as Government Insurance, still survives from World War I. Participating policies were issued during World War II and until 1951. With the Korean war, a new nonparticipating form of policy was substituted.

On all of these, the costs of administration are paid out of the general expenses of the government and are not borne directly by the policyholders. During wartime, claims resulting from military action overseas were paid out of a special fund set up by Congress and not out of the regular insurance fund. Naturally, there have been none of the commissions or other selling expenses applicable to commercial insurance. All this has had the effect of making GI insurance a real bargain.

While the basic premium rate was low, it could have been lower. A friend who was loaned to the government by the insurance industry to help set up the World War II coverage once told me that it could have been sold at a flat rate of 25 cents per month per $1000. Very substantial dividends have been paid on the participating policies, however. Despite these, a substantial surplus has accumulated. A politically minded administration recently ordered that dividends be paid six months ahead of schedule to stimulate the economy during a period of temporary recession. There can be no question but that the release of these millions of dollars early was a stimulant. There are people who view with alarm any such intrusion into the orderly processes of the insurance administration, however well-intentioned that intrusion may be.

Most of the policies now in force are, or were, five-year renewable term insurance. I say were, because the Veterans

Administration has exerted continuous pressure upon veterans to convert to "permanent" insurance, with the result that many of the priceless five-year term policies have been surrendered to be replaced with ordinary life policies and other forms of cash value insurance. Naturally, every insurance company is anxious to have the policyholder build as much cash value as possible to offset the company's loss in the event of a claim—and the insurance men who administer GI insurance are no exception. Many veterans have been influenced by the fact that the recommendation to convert came from the government—they assumed that the government had no axe to grind and could be depended upon to give them unbiased advice. They failed to take into account that the people who administer GI insurance were recruited from the insurance industry and those people share the industry's antipathy to pure protection.

Under the five-year term policy which you may now own, you must pay premiums as long as you live and the government is obligated to pay the face amount when you die. Under the policy to which the Veterans Administration would have you convert, you will still pay premiums as long as you live and the government will still pay the face amount when you die. Obviously, if the government is going to pay when you die, the smartest thing would be for you to give them as little money as you can between now and the time you die. What will you gain, then, converting to a policy which calls for premiums three or four times as large as those you now pay?

The veteran should spend all of his available premium money buying protection and not waste any of it buying savings accounts in conjunction with his insurance policy. If he wishes a savings account—and everyone should have such an emergency fund—let him open it in a savings bank, not with the Veterans Administration. If he dies, under this arrangement his family will have all the insurance plus all of the money in the savings bank—instead of letting the Veterans Administration use his savings account to help pay the insurance claim.

Be wary, then, of suggestions that you should convert your term coverage to cash value insurance.

Life insurance agents have been known to encourage the abandonment of National Service Life Insurance.

In an earlier chapter of this book, I detailed the successful

efforts of the life insurance men to block the reopening of the sale of GI insurance to veterans who had never applied for it or who, owning it, had been forced to drop it for one reason or another. The National Underwriters Association has bitterly fought GI insurance since it was first made available. Many veterans who abandoned their valuable coverage did so at the urging of an insurance salesman who then made a commission by selling a new policy to replace the lost GI coverage.

This ugly campaign to rob the veteran of the benefits of NSLI took on such proportions that the *National Underwriter* editorially warned the industry that it had better watch its step. Urging the companies to curb their desire to get new business at the expense of NSLI, the trade journal said:

> Life insurance men have done much to keep the record from being no worse than it is but can the institution of life insurance say, on the basis of what it is doing now, that it is doing all that it could reasonably be expected to do about preventing the twisting of National Service Life Insurance?
>
> So far as we know, no company officials encourage the twisting of NSLI but there are many who are not particularly active about discouraging it or about inquiring whether new policies represent a twisted NSLI insurance and there is not enough curiosity about what led up to the purchase of insurance on ex-servicemen. In the days when the twisting of business from one company to another got to be a serious matter the companies, though unable to stop it completely, instituted some very effective curbs. It would seem that the same sort of curbs should be used by all companies with respect to twisting or replacement of National Service Life Insurance.
>
> Admittedly NSLI is a tempting target for agents. In many respects it seems less reprehensible to twist NSLI than to twist business from a life company.

I shall not comment here upon the ethical standards which hold it to be less reprehensible to rob a veteran of the priceless benefits of low-cost government insurance than to suggest

that he give up a commerical policy in another company with possible resultant loss of revenue and profit to that other company. I shall just express the hope that the nation's veterans will never forget what they "owe" the life underwriters.

My suggestion to veterans is this: Like Ulysses, who had himself tied to the mast when his ship was scheduled to pass the sirens of mythology, tie yourself to your original, unconverted GI policy and never let anyone talk you out of it.

Chapter 34

Social Security

SOCIAL SECURITY is a form of insurance. It pays a small lump sum in cash at death and a substantial continuing monthly income to a widow with children under age 18. Each individual covered by Social Security is entitled to receive a monthly annuity beginning at age 65, women having the option of electing a reduced annuity to begin at age 62. Persons who become totally disabled are entitled to begin drawing their income earlier, at age 50.

The critics of Social Security—and it has its critics—fall roughly into two groups. The first is a relative handful of rugged individualists who claim that guaranteeing retirement security in this fashion is softening the race. The pioneer spirit is gone, they say. No one wants to work hard to get ahead any more; people just sit back and wait to collect their Social Security.

The second group of critics of Social Security, of whom I am one, readily acknowledge that Social Security is a fine thing. They just claim that it should be operated on a businesslike basis as any insurance company should be—and it *is* an insurance company. You are one of the policyholders and so you should know the facts about its operation. Curiously, the complaint is just the opposite of that which has characterized our observations on the subject of legal reserve life insurance companies. While the latter grow too fat at our expense, the Old Age and Survivors Insurance Fund grows too lean.

The major difference between Social Security and private insurance is that private insurance is based upon contractual rights. Each individual determines his own interest in the objective and his capacity to meet the contractual obligations which he must assume as his part of the bargain.

Social Security rights are statutory rights which may be changed at the whim of Congress without requiring the assent of the "policyholder." Once a private insurance company issues a policy, both premium and benefits are fixed and can-

not be altered by the company. The Social Security policyholder has no such guarantee. Next year's Congress may boost his premiums or alter his benefits. Belgium had Social Security; when the Belgian government found that it had bitten off more than it could chew, it cut back the benefits.

In private insurance, risks are pooled among the contributors to the plan. Under our present unfunded, pay-as-you-go system, the working generation supports the retired generation.

Mother Hubbard's Cupboard

If the Social Security Administration were a private insurance company with outstanding policy obligations equal to those it now bears, it would be required by law to have policy reserves in excess of $350 billion. It claims reserves of $21.5 billion. Actually, it has *no* reserves. As fast as the money came in, it was handed over to the Treasury for everyday expenses of the government. Government bonds and treasury notes—Uncle Sam's IOUs—were placed in the box. In the fiscal year ending June 30, 1960, the Old Age and Survivors Insurance Trust Fund took in $10.343 billion and paid out $11.055 billion. For four years in a row, outgo has exceeded income and the fund is shrinking. Since each year more people cross over from the paying to the receiving side of Social Security, the outlook is hardly encouraging.

The premiums which we pay in now, which are supposed to be put away to provide our retirement benefits at age 65, are instead being used to pay Social Security benefits to those who came before us. As fast as they were received, *their* payments were siphoned off for other expenses of government, leaving their accounts empty.

The people who run Social Security are sensitive about the charge that the box is full of IOUs and not cash. They reply that other insurance companies own government bonds and no one accuses *them* of holding IOUs. The answer is simple —when a private insurance company sells a government bond, it collects from *someone else*. When the Old Age and Survivors Insurance Trust sells a government bond, the government—for this *is* an instrumentality of the government—is simply collecting from itself. To put cash in one pocket, it must take it out of another pocket.

This is an adaptation of the old Rooseveltian economic

theory exemplified by his remark "After all, we owe it to ourselves."

But what about the claimed reserves of $21.5 billion dollars in the face of policy obligations calling for reserves of $350 billion? Their explanation for this is a lulu. Let me quote it verbatim from their booklet, *Facts about the Old Age and Survivors Insurance Trust Fund.*

> Private life insurance companies must have reserves equal to the present value of all benefits less the present value of future premiums. These reserves are required by law because the private company must be prepared to pay benefit liabilities or cash surrender values even if it should cease writing new business.
>
> The Federal program, on the other hand, since it is compulsory under Federal law, can count on continuing participation in the program and the continuing payment of contributions.

What do you think of that?

Doesn't it seem familiar? Haven't you heard of that system somewhere before?

Yes, you have. A generation ago in Boston, a man named Charles Ponzi devised an investment scheme guaranteeing people 10% per month on their savings. From the money paid in by investors this month, he paid the "interest" to those who had invested last month. Uncle Sam stepped in, branded Ponzi a thief and sent him to jail for 20 years—the same Uncle Sam who is today operating Social Security as the greatest Ponzi-type scheme of all time. If the people who are responsible for running this were operating a private insurance company, they would long since have been clapped into jail for failing to maintain the assets required by law.

Small boys express it by saying, "Last one in's a rotten egg!" When they get older, it may take the form of a chain letter, with the final few letter-writers holding the bag. When they are old enough to work, the idea pops up again. This time, it's called Social Security—and the last generation in is a rotten egg.

Spend and Spend . . .

Each successive Congress vies with its predecessors in extending Social Security benefits. No one seems to worry about

where the money is coming from. Our forefathers, who bequeathed us a pleasant country in good financial condition, must be turning over in their graves at what we are doing to it and to our children and our children's children.

Elmer F. Wollenberg, in his paper "Vested Rights in Social Security," observed:

> A system of contractual social insurance involves the arrogant assumption that ours is the wisest generation of Americans for some time to come. If we have the legal power to tell generations yet unborn how the national income shall be distributed in some indefinite future, we shall have to be very clever in the way we assert that prerogative.

Our only hope is that the next generation, or at least the one after that, will be financially more responsible than we have been and will call a halt to the easy downhill slide into insolvency. Human nature being what it is, I'm afraid it won't, though. When it comes to governmental dispensing of money, there is no turning back. Largesse handed out in the name of social progress can never be withdrawn. Its recipients acquire a vested interest in its continuance.

No one is against financial security for the aged. On the other hand, unlimited spending could provide a happy solution to many other problems—substandard housing, crowded jails, too few schools, etc. Money will solve all our problems if we have enough of it to spend. Unfortunately, we do not.

A family in need of a new car, new living-room furniture, or a new wardrobe for each of its members could solve all these problems simply by going downtown and buying right and left. We'd have small patience, though, with a family which chose this solution of its problem without having the money to pay the bills next month or at least in the foreseeable future.

Yet that is precisely what we are doing with Social Security. It is a wonderful thing—but who's paying for it?

If today's new "policyholder" in Social Security knew what a huge financial burden lies ahead for him, he would rebel.

The early Communists predicated that they would take the world without a fight. Capitalism would collapse of its own weight, they said, and the capitalist world would fall into their

hands like a ripe plum. If we continue as we are doing, they will be proved right.

The Keynesian socialists who designed our Social Security system have figured that it won't collapse as long as the government has the right to tax us endlessly to raise the money. It is a fact, though, that no nation can go on indefinitely spending money it doesn't have.

In the warm sunshine of Social Security, we are headed down the road to national bankruptcy.

Let's not run any faster than we have to.

EPILOGUE

Epilogue

I'M SORRY THAT I've had to write this book. I'm sure that it will pain deeply a great many good friends of mine in the life insurance industry. I am confident, though, that any reader not personally identified with the industry will agree that if the facts I have reported do exist, they should not remain hidden. Like a pan with many tiny leaks, none important by itself but which nevertheless collectively drain the contents, so does life insurance, with an inequity here and an advantage taken there, drain the financial security of the American people.

At the outset I declared my firm intention of reporting the facts without bitterness or venom. I believe I have done so.

I did not say that I would do it without exhibiting impatience or even heat. No one could assemble and record the facts as I have tried to do without a rising resentment at the enormity of the life insurance industry's abuses against the financial security of the American people.

My reaction is not, "Throw the rascals out!" We, you and I, have a share of the blame, for we have given the life insurance industry enormous financial power and resources and have left it to operate under its own devices in what is essentially a regulatory vacuum. The men who run the life insurance industry are not all dishonest. On the other hand, they are not supermen; they are ordinary mortals who are part of an industry which attracts aggressive, ambitious men. They have gradually fallen deeper and deeper into the ugly mire of their present practices simply because no one has ever told them that they should not, could not, do these things. You cannot charge a man with breaking a law which has never been written.

True, minimum standards of morality might have dictated another course, but greed is a common human characteristic —and who would like to be first to point the finger?

What we must do is resolve here and now that this giant shall be brought under control, that this industry which in one way or another reaches into the life of practically every living American, shall be strictly regulated from this day for-

ward. Just as the Securities and Exchange Commission was created to administer the securities laws of the land, so we must have a counterpart to administer federal insurance laws which our legislative representatives must move swiftly to pass.

Two generations ago, Charles Evans Hughes, then a relatively little-known lawyer, did a good job as counsel for the Armstrong Joint Legislative Inquiry in New York state. There was so much about the industry's operations then that was openly crooked that he had no trouble finding things to investigate. He didn't go into the mechanics of insurance to any degree. Perhaps he was too busy with the other angles. His father-in-law was a senior partner in a law firm, one of the largest in New York, which was counsel for one of the big mutual companies. The investigation concluded, Hughes himself became a director of a large life insurance company. He had two assistants. When the inquiry was over, each of the assistants became counsel to a company which he had only recently been investigating. By a strange coincidence, two legislator members of the committee also entered into life time jobs with two other companies.

This seems to be a pattern for such committees. Only a year or two ago, the Senate Anti-Trust and Monopoly subcommittee on insurance conducted hearings in the field of casualty insurance. There was a great deal of interesting testimony but nothing ever came of it—unless you consider it an advantage that shortly afterward the chief counsel for the investigating committee became vice-president and general counsel of one of the companies he had only a little while before been investigating.

Charles Evans Hughes did administer a cathartic to an industry plagued with malefactors, and he carried the grateful affection of his fellow Americans with him all the rest of his life, even to within an inch of the presidency. As governor of New York, as Secretary of State, and then as Chief Justice, he was honored with the confidence of the country.

Where, now, will the American people find a champion willing and able to harness the strength of this financial giant? Who will lay the present sorry mess open to the light of day? Where shall we find a man with the termerity to face these latter-day "untouchables," to stand in the path of this juggernaut and cry *"Halt!"*

Does he sit in the halls of Congress, or at some obscure

state attorney general's desk? Who is to recruit him to the cause, who pay his way?

When he is found and takes the job and does it, he will never be forgotten, for he will have brought the American people more financial independence and self-respect than a hundred years of Social Security.

George Bernard Shaw once wrote: "Nobody who does not understand insurance and comprehend in some degree its enormous possibilities is qualified to meddle in national business."

Twenty-five years ago, in the course of its study of the concentration of economic power in our country, Congress took a close look at the life insurance industry and concluded that gross abuses were commonplace and that the premium rates which people paid were "arrived at by concerted action designed to eliminate competition." Didn't "concerted action designed to eliminate competition" in another industry send some leading businessmen to jail not so long ago?

But the report of this investigation has remained buried for a quarter of a century. The abuses have multiplied to the point where even the insurance men themselves are appalled at what is going on.

A Senate committee is now planning an investigation of insurance sold by mail. This is the equivalent of pursuing a mosquito during a thousand-plane bombing raid.

Now is the time for a thorough study of every phase of the life insurance industry—but this time something must be done about it. Its objective must be the speedy enactment of legislation providing for federal regulation of life insurance.

It's *your* money, *your* security. *You* must do something about it. Begin by making your feelings known to your own legislative representatives without delay.

APPENDIX

Appendix

On the following pages are tables which should be of interest. Tables 17 through 22 prove conclusively that stock companies sell insurance cheaper than dividend-paying mutual companies, despite the fact that the former are operated for profit and must pay dividends to stockholders.

Tables 23 through 25 compare the actual dividend record of mutual companies with the projections offered when the policies were sold. They show that with only scattered exceptions, the mutual companies have failed miserably to make good on their dividend promises.

TABLE 17

COST COMPARISON

20-YEAR ENDOWMENT—AGE 35—ISSUED 1940
$10,000

$519.10 Participating—New York Life
441.80 Non-participating—(see* below)
$ 77.30 Premium Differential—Column (1)

Year	(1) Gross Premium Differential	(2)** Annual Premium Rebate	(3) Net Premium Differential	(4) Differential Accumulated Without Increase	(5)*** Differential Accumulated @ 4% Interest	(6)*** Differential Accumulated @ 6% Interest
1	$77.30	$ .00	$77.30	$ 77.30	$ 80.39	$ 81.94
2	77.30	.00	77.30	154.60	164.00	168.79
3	77.30	65.80	11.50	166.10	182.52	191.11
4	77.30	66.20	11.10	177.20	201.36	214.34
5	77.30	66.90	10.40	187.60	220.23	238.22
6	77.30	67.40	9.90	197.50	239.34	263.00
7	77.30	68.40	8.90	206.40	258.17	288.21
8	77.30	69.40	7.90	214.30	276.71	313.88
9	77.30	52.10	25.20	239.50	313.99	359.42
10	77.30	57.30	20.00	259.50	347.35	402.19
11	77.30	108.40	—31.10	228.40	328.90	393.36
12	77.30	65.40	11.90	240.30	354.43	429.58

13	77.30	66.90	10.40	250.70	379.42	466.38
14	77.30	73.80	3.50	254.20	398.24	498.07
15	77.30	76.40	.90	255.10	415.11	528.91
16	77.30	128.00	−50.70	204.40	378.99	506.90
17	77.30	83.80	− 6.50	197.90	387.39	530.42
18	77.30	86.10	− 8.80	189.10	393.73	552.92
19	77.30	93.20	−15.90	173.20	392.94	569.24
20	77.30	95.60	−18.30	154.30	389.63	584.00
(20)	——	109.20	——			
	Accumulated differential end of 20th year			−109.20	−109.20	−109.20
	reduced by dividend then payable			45.10	280.43	474.80

Formula

Column (3) = (1) − (2)
Column (4) = (3) + (4) previous year
Column (5) = ((3) + (5) previous year) × (1.04)
Column (6) = ((3) + (6) previous year) × (1.06)

*All these companies quoted $44.18 in 1940: Aetna; Atlantic; Bankers, Nebr.; Conn. Gen'l.; Cont. Assur.; Equitable, D.C.; Life of Va.; Occidental, Calif.; Old Line Life; Sun, Canada; Travelers; U.S. Life

**Actual rebate history—*Unique Manual,* 1940, 1960

***Interest accumulated at the end of each policy year

TABLE 18

COST COMPARISON

20-PAY LIFE—AGE 45—ISSUED 1940
$10,000

$477.20 Participating—Metropolitan
375.50 Non-participating—Southland
$ 71.70 Premium Differential—Column (1)

Year	(1) Gross Premium Differential	(2)* Annual Premium Rebate	(3) Net Premium Differential	(4) Differential Accumulated Without Interest	(5)** Differential Accumulated @ 4% Interest
1	$71.70	$ .00	$ 71.70	$ 71.70	$ 74.57
2	71.70	.00	71.70	143.40	152.12
3	71.70	.00	71.70	215.10	232.77
4	71.70	38.30	33.40	248.50	276.82
5	71.70	48.60	23.10	271.60	311.92
6	71.70	54.60	17.10	288.70	342.18
7	71.70	58.10	13.60	302.30	370.01
8	71.70	59.80	11.90	314.20	397.19
9	71.70	57.30	14.40	328.60	428.05
10	71.70	58.20	13.50	342.10	459.21

11	71.70	59.10	12.60	354.70	490.68
12	71.70	60.20	11.50	366.20	522.27
13	71.70	61.30	10.40	376.60	553.98
14	71.70	62.40	9.30	385.90	585.81
15	71.70	82.70	−11.00	374.90	597.80
16	71.70	85.80	−14.10	360.80	607.05
17	71.70	88.30	−16.60	344.20	614.07
18	71.70	90.80	−19.10	325.10	618.77
19	71.70	93.30	−21.60	303.50	621.06
20	71.70	98.00	−26.30	277.20	618.55
(20)	——	101.50	−101.50	−101.50	−101.50
Accumulated differential end of 20th year reduced by dividend then payable				175.70	517.05

Formula

Column (3) = (1) − (2)
Column (4) = (3) + (4) previous year
Column (5) = ((3) + (5) previous year) × (1.04)

*Actual rebate history—*Unique Manual,* 1940, 1960

**Interest accumulated at the end of each policy year

TABLE 19

COST COMPARISON

20-YEAR ENDOWMENT—AGE 35—ISSUED 1940
$10,000

$498.50	Participating—Home Life
430.50	Non-participating—National Life & Accident
$ 68.00	Premium Differential—Column (1)

No.	*Year*	*(1) Gross Premium Differential*	*(2)* Annual Premium Rebate*	*(3) Net Premium Differential*	*(4) Differential Accumulated Without Interest*	*(5)** Differential Accumulated @ 4% Interest*
1.	1941	$68.00	$ .00	$68.00	$ 68.00	$ 70.72
2.	1942	68.00	34.10	33.90	101.90	108.80
3.	1943	68.00	33.50	34.50	136.40	149.03
4.	1944	68.00	30.60	37.40	173.80	193.89
5.	1945	68.00	31.30	36.70	210.50	239.81
6.	1946	68.00	32.10	35.90	246.40	286.74
7.	1947	68.00	32.90	35.10	281.50	334.71

8.	1948	68.00	33.70	34.30	315.80	383.77
9.	1949	68.00	31.30	36.70	352.50	437.29
10.	1950	68.00	31.80	36.20	388.70	492.43
11.	1951	68.00	32.30	35.70	424.40	549.26
12.	1952	68.00	32.80	35.20	459.60	607.84
13.	1953	68.00	33.30	34.70	494.30	668.24
14.	1954	68.00	33.80	34.20	528.50	730.54
15.	1955	68.00	34.40	33.60	562.10	794.71
16.	1956	68.00	35.50	32.50	594.60	860.30
17.	1957	68.00	36.10	31.90	626.50	927.89
18.	1958	68.00	49.20	18.80	645.30	984.56
19.	1959	68.00	50.50	17.50	662.80	1,042.14
20.	1960	68.00	51.90	16.10	678.90	1,100.57
(20.)	(1960)	——	53.30			
				−53.30	−53.30	−53.30
					**625.60	**1,047.27

*Actual rebate history—Authoritative reporting service.

**Accumulated differential end of 20th year reduced by dividend then payable.

TABLE 20

COMPARISON—ESTIMATED vs. ACTUAL 20-YEAR COSTS
POLICIES ISSUED IN 1934 AT AGE 35

	ORDINARY LIFE					*20-PAY LIFE*				
	Annual	*Dividends*		*Cost*		*Annual*	*Dividends*		*Cost*	
	Premium	*Est.*	*Actual*	*Est.*	*Actual*	*Premium*	*Est.*	*Actual*	*Est.*	*Actual*
Connecticut Mutual	$26.35	$ 94.52	$115.54	$432.48	$411.46	$35.82	$113.40	$117.35	$603.00	$599.05
Equitable, N.Y.	28.11	165.26	157.56	396.94	404.64	38.34	209.69	162.29	577.11	604.51
*John Hancock	24.60	76.16	70.07	415.84	421.93	32.95	91.76	73.41	567.24	585.59
Mass. Mutual	26.35	107.75	101.58	419.25	425.42	36.17	135.51	106.44	587.89	616.96
*Metropolitan	24.00	123.35	68.52	356.65	411.48	32.13	134.47	61.08	508.13	581.52
Mutual Benefit, N.J.	26.35	106.68	99.47	420.32	427.53	36.22	129.83	97.15	594.57	627.25
Mutual Life, N.Y.	28.11	142.81	113.59	419.39	448.61	38.34	185.89	112.92	580.91	653.88
National Life, Vt.	26.35	†	127.39	†	399.61	36.00	†	122.52	†	597.48
New England Mutual	27.00	182.75	119.19	357.25	420.81	36.70	212.15	123.99	521.85	610.01
New York Life	28.11	164.28	141.09	397.92	421.11	38.34	204.27	149.10	562.53	617.70
Northwestern Mutual	28.88	146.77	144.84	390.83	392.76	36.85	175.79	147.29	561.21	589.71
Pacific Mutual	26.35	105.72	73.32	420.28	452.68	34.95	124.81	67.09	574.19	631.91
Penn Mutual	26.35	135.20	109.66	391.80	417.34	36.22	153.42	106.59	570.98	617.81
Phoenix Mutual	23.10	55.81	46.47	406.19	415.53	31.19	65.16	33.01	558.64	590.79
Prudential		(figures not available)				31.51	†	33.22	†	585.58
State Mutual	26.35	107.90	96.82	419.10	430.18	36.00	129.89	96.42	590.11	623.58
Sun Life, Canada	27.90	114.03	123.36	434.64	437.75	37.35	141.34	117.05	605.66	629.95
Travelers	20.06	(no dividend)		401.20	401.20	27.82	(no dividends)		556.40	556.40

Figures derived from *Unique Manual*, 1934, 1954

*Endowment-at-age-85 rates shown—no regular ordinary life issued.
†Only 10-year estimates given in 1934.

TABLE 21

COMPARISON—ESTIMATED vs. ACTUAL 20-YEAR COSTS—POLICIES ISSUED IN 1934 AT AGE 35
20-YEAR ENDOWMENT

Company	*Annual Premium*	*Dividends*		*Cost*	
		Estimated	*Actual*	*Estimated*	*Actual*
Connecticut Mutual	$50.36	$164.32	$136.12	$842.88	$871.08
Equitable, N.Y.	51.91	259.96	166.09	778.24	872.11
John Hancock	47.33	118.64	79.22	827.96	867.38
Mass. Mutual	49.75	175.06	113.46	819.94	881.54
Metropolitan	46.12	231.30	59.73	691.10	862.67
Mutual Benefit, N.J.	49.85	161.50	107.03	835.50	889.97
Mutual Life, N.Y.	51.47	229.95	105.87	799.45	923.53
National Life, Vt.	49.33	†	113.76	†	872.84
New England Mutual	50.00	253.10	130.64	746.90	869.36
New York Life	51.91	247.83	149.78	790.38	888.42
Northwestern Mutual	50.64	216.06	156.76	796.74	856.04
Pacific Mutual	49.75	168.76	66.91	826.24	928.09
Penn Mutual	50.11	183.32	111.15	818.88	891.05
Phoenix Mutual	44.92	81.14	24.04	817.26	874.36
Prudential	45.43	†	33.73	†	859.27
State Mutual	49.32	160.42	96.33	825.98	890.07
Sun Life, Canada	51.00	181.00	126.61	839.00	893.39
Travelers	42.09	(no dividend)		841.80	841.80

Figures derived from *Unique Manual*, 1934, 1954

†Only 10-year estimates given in 1934.

TABLE 22

HISTORY OF MUTUAL VERSUS GUARANTEED-COST INSURANCE

20-PAYMENT LIFE—AGE 35 (1940-1960)
$10,000

$367.00 Average premium ten mutual companies*
299.40 Average premium ten "guaranteed cost" companies
$ 67.60 Average premium differential—Column (1)

No.	*Year*	*(1) Gross Premium Differential*	*(2)** Annual Premium Rebate*	*(3) Net Premium Differential*	*(4) Differential Accumulated Without Interest*	*(5)*** Differential Accumulated @ 4% Interest*
1.	1941	$67.60	$ .00	$ 67.60	$ 67.60	$ 70.30
2.	1942	67.60	21.71	45.89	113.49	120.84
3.	1943	67.60	46.01	21.59	135.08	148.13
4.	1944	67.60	50.98	16.62	151.70	171.34
5.	1945	67.60	54.19	13.41	165.11	192.14
6.	1946	67.60	67.08	.52	165.63	200.37
7.	1947	67.60	58.21	9.39	175.02	218.15
8.	1948	67.60	58.48	9.12	184.14	236.36
9.	1949	67.60	55.41	12.19	196.33	258.49
10.	1950	67.60	55.08	12.52	208.85	281.85

11.	1951	67.60	61.05	6.55	215.40	299.94
12.	1952	67.60	59.47	8.13	223.53	320.39
13.	1953	67.60	60.07	7.53	231.06	341.04
14.	1954	67.60	62.23	5.37	236.43	360.27
15.	1955	67.60	65.75	1.85	238.28	376.60
16.	1956	67.60	77.41	−9.81	228.47	381.46
17.	1957	67.60	74.05	−6.45	222.02	390.01
18.	1958	67.60	76.42	−8.82	213.20	396.44
19.	1959	67.60	81.25	−13.65	199.55	398.10
20.	1960	67.60	84.78	−17.18	182.37	396.16
(20.)		——	105.87			
				−105.87	−105.87	−105.87
Accumulated differential end of 20th year reduced by dividend then payable					76.50	290.29

Formula

Column (3) = (1) − (2)
Column (4) = (3) + (4) previous year
Column (5) = ((3) + (5) previous year) × (1.04)

*Metropolitan; Prudential; Equitable, N.Y.; John Hancock; New York Life; Northwestern, Wis.; Mutual of N.Y.; Mass. Mutual; New England Mutual; Penn Mutual.

**Guaranteed cost companies (rates from the *Unique Manual*, 1940, 1960): Travelers; National L. & A.; American National; Provident L. & A.; Southwestern; Life & Casualty of Tenn.; Bus. Men's Assurance; Kansas City Life; Southland Life; Life of Virginia.

***Interest accumulated at end of each policy year.

TABLE 23

DIVIDEND HISTORY—1940–1960—AGE 35
PERCENTAGE OF PAYMENT TO PROJECTION

No.	*Company*	*Ordinary Life*	*20-Pay Life*	*20-Year Endowment*
1.	Berkshire Life, Mass.	99.40%	88.12%	77.97%
2.	Central Life, Iowa	93.97%	76.18%	68.84%
3.	Conn. Mutual Life, Conn.	——	——	82.95%
4.	Equitable Life, N.Y.	——	95.37%	86.52%
5.	Fidelity Mutual Life, Pa.	76.54%	65.85%	56.02%
6.	Guardian Life, N.Y.	96.25%	——	——
7.	Home Life, N.Y.	84.95%	71.49%	59.39%
8.	John Hanc'k Mut. Life, Mass.	98.59%	82.59%	71.50%
9.	Mass. Mutual Life, Mass.	——	86.58%	75.06%
10.	Metropolitan Life, N.Y.	98.26%	80.96%	54.78%
11.	Mutual Benefit Life, N.J.	99.82%	79.48%	73.04%
12.	Mutual Life, N.Y.	——	——	——
13.	National Life, Vt.	——	93.78%	73.13%
14.	New Eng. Mut. Life, Mass.	——	93.16%	79.95%
15.	New York Life, N.Y.	89.83%	74.19%	72.05%
16.	Northwestern Mut. Life, Wis.	——	90.79%	74.13%
17.	Pacific Mutual Life, Calif.	91.75%	70.61%	63.03%
18.	Penn Mutual Life, Pa.	95.21%	90.66%	84.34%
19.	Phoenix Mutual Life, Conn.	92.70%	67.18%	38.46%
20.	Provident Mutual Life, Pa.	93.02%	80.68%	68.07%
21.	Prudential Insurance Co., N.J.	——	68.04%	55.28%
22.	State Mutual Life, Mass.	85.34%	69.80%	55.24%

The above figures are compiled from the *Diamond Life Bulletins Statistical Service,* from *Unique Manual* and *Little Gem.*

Explanation of Table 23: This shows the tremendous margin of error in projected and actual rebate payments. The blank spaces indicate that the company exceeded the amount of rebates projected in 1940. Of the 22 companies involved, 8 paid rebates in excess of their 1940 projection on the ordinary life plan: 3, on the 20-pay life plan, and only 2 on the 20-year endowment plan. Only one company, Mutual of New York, paid rebates in excess of expectation on all 3 plans; Guardian Life was the only company that paid excessive rebates on the 20-pay life and 20-year endowment plans, but failed to come up to scratch on the ordinary life plan. Berkshire Life, Central Life of Iowa, Fidelity Mutual, Home Life, John Hancock, Metropolitan, Mutual Benefit, New York Life, Pacific Mutual, Penn Mutual, Phoenix Mutual, Provident Mutual, and State Mutual failed to pay projected rebates *on all 3 plans.*

Please note also the percentage by which some of the companies missed their projection—Phoenix Mutual, 38.46% of projected;

Prudential, 55.28%; Metropolitan, 54.78%; Fidelity Mutual, 56.02%, etc.

We might at this point ask a leading question: If these companies, which are among the oldest, largest, and most powerful in the entire insurance field, cannot do better on their rebate projections than indicated here (and during the most prosperous era in our economic history), how can anyone at any time place any material credence in the rebate projections advanced by these or any other company?

As a matter of interest, the above histories are predicated on percentages only, and Mutual of New York, which on this endowment plan paid 111.94% of the projection made in 1940, showed a "net rate" of $44.44. New York Life paid only 72.05% of its projection, but the average premium was only $44.41 for the 20-year period.

TABLE 24

FACTS AND FIGURES ON DIVIDENDS
20 YEARS OF ACTUAL DIVIDEND EXPERIENCE

		Present Scale vs. Actual		
	Leading Mutual Companies	*Published Predications Present Scale 1932*	*Dividends Paid Actual 1932–1952*	*Variation*
1.	Metropolitan	$ 102.89	$ 63.01	39%
2.	Prudential	41.59	36.35	13%
3.	Equitable, N.Y.	192.13	154.42	20%
4.	John Hancock*	116.78	75.23	36%
5.	New York Life	206.63	140.23	32%
6.	Northwestern Mutual	205.15	147.04	28%
7.	Mutual Life, N.Y.	185.81	110.75	40%
8.	Mass. Mutual	159.81	101.39	37%
9.	New England Mutual	182.75	124.03	32%
10.	Mutual Benefits	168.47	100.99	40%
11.	Penn Mutual	165.43	113.52	31%
12.	Conn. Mutual	151.42	110.61	27%
13.	Bankers, Iowa	166.82	120.69	28%
14.	Provident Mutual	112.76	57.77	49%
15.	State Mutual, Mass.	173.75	100.12	42%
16.	National Life, Vt.	146.69	122.03	17%
17.	Pacific Mutual	162.00	74.49	54%
18.	Phoenix Mutual	88.92	47.48	47%
19.	Guardian, N.Y.	149.90	91.44	39%
20.	Minnesota Mutual*	151.67	76.91	49%
	Totals	$3,031.37	$1,968.50	49%
	Average variation UNDER published scales			35%

*Endowment at age 85

All figures based on ordinary life, age 36

EXPLANATION OF TABLE 24: These projections published in 1932 and the amount which had actually been rebated by 1952, with the resulting variations, are again a very forceful reminder that credence cannot be placed in rebate projections. These figures were compiled from the *Unique Manual,* 1932 and 1952 editions. The average rebate projected amounted to $151.52, whereas the actual rebate paid averaged $98.42, a differential of $53.10. The figure $53.10, does not of itself seem startling, but some idea of the magnitude of the error can be gained if we think in terms of one billion in lieu of one thousand dollars. The error in rebate now becomes $53 million, a rather startling figure, and this represents less than half of one per cent of the total insurance carried by the above-listed companies.

In studying the above figures in this table, it is interesting to note that there is very little correlation between the amount in dollars and cents of rebates projected and the amount actually paid. For instance, Phoenix Mutual only projected $88.92 and paid approximately half of this amount, whereas Mutual Life of New York projected almost $100 more and paid 40 percent of the projection.

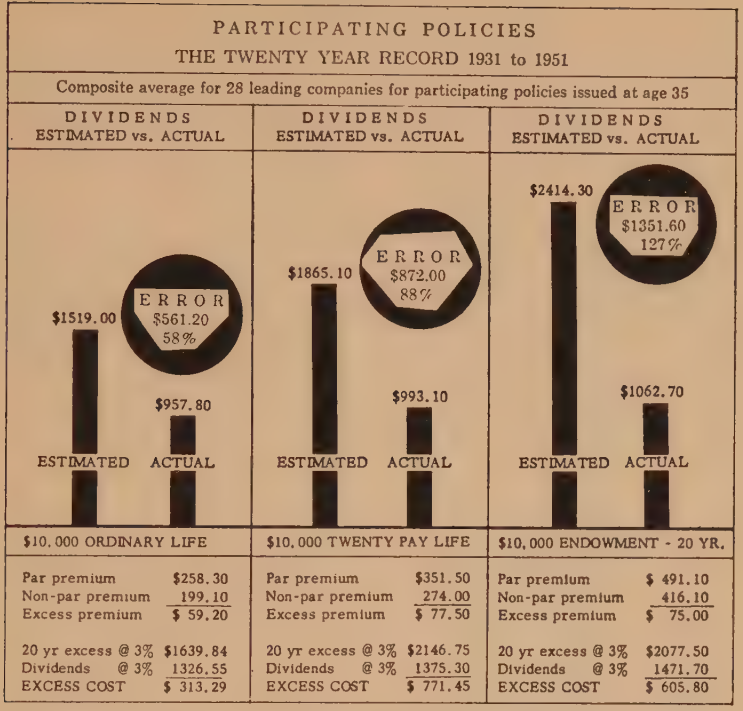
It is a foregone conclusion that the majority of policyholders who bought these policies in 1932 based their purchase on the figures as illustrated in column 1. No comment is necessary as to the disappointment involved.

TABLE 25

WHAT HAS HAPPENED TO DIVIDENDS
1927–1947

	Ordinary Life		*20-Year Endowment*	
Company	*Estimated*	*Actual*	*Estimated*	*Actual*
A	$ 9.10	$3.92	$17.61	$4.77
B	6.67	3.61	15.62	2.33
C	10.11	6.55	21.72	8.14
D	10.50	5.30	16.87	5.03
E	9.27	4.15	16.80	3.60
F	10.47	6.26	21.85	6.22
G	11.56	5.96	20.00	7.22
H	9.96	7.53	19.87	9.07
I	10.95	7.18	18.90	9.25
J	11.91	8.40	23.00	7.54
K	11.13	5.97	21.84	5.57
L	10.25	7.04	11.08	.60
M	9.09	4.50	13.88	2.07
N	8.42	2.32	14.72	.00
Average 14 companies	9.96	5.62	18.13	5.10

CHART 15



Participating policies are issued by all mutual companies. Stock companies generally issue both participating (par) and nonparticipating (non-par) policies. Premiums for participating policies average 15% to 25% higher than for nonparticipating policies.

Dividends are a refund to the policyholder of the unused portion of this excess premium. The amount of refund is determined by the company yearly—and may be more or less than the excess added into the premium. Dividends are not guaranteed and have nothing to do with the cash value which is guaranteed and is the same for par and non-par policies.

Dividend estimates are unguaranteed schedules showing the amount of refund the company expects to pay back in the form of dividends. Schedules are usually projected for twenty years and are used as sales propaganda to help justify the higher than necessary premium.

The tremendous "errors" made by the companies in dividend estimates in the past are illustrated in the above chart. What these "errors" have cost policyholders is also shown.

NOTE: During this period the average dividends of 30 leading industrial companies increased 200% and the value of their shares 360%.

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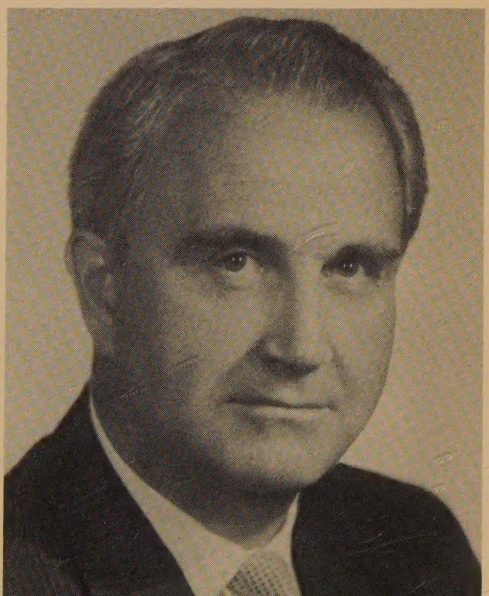

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